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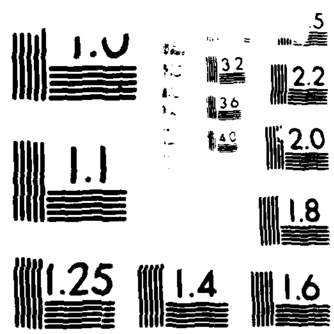
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Few military officers have been taught how to effectively manage the money that they earn; the busier and more successful they become in their careers, the less time they have to do so. Today's ever-changing tax and military retirement laws, and unpredictable inflation, interest rates, and financial markets make it even more difficult to plan for their own personal financial future. To overcome these difficulties requires a comprehensive, personalized but easy-to-create financial plan of action. This publication
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provides the knowledge, tools, and framework for creating financial strategies which are oriented upon and appropriate to the requirements of senior military officers. Utilizing a building-block concept, and supported by appropriate planning forms, the reader is taken through a five-step integrated process: (1) Defining personal objectives; (2) Employing a variety of techniques to help protect assets; (3) Accumulating wealth through creating additional cash flows and investing in a diversified portfolio matched to appropriate risk-reward levels; (4) Establishing retirement and education funds; (5) Preserving current and future assets through tax and estate planning initiatives. This model permits the creation of a dynamic financial plan capable of focusing on goals and objectives which change over one's career and lifetime.

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USAWC MILITARY STUDIES PROGRAM PAPER

FINANCIAL PLANNING STRATEGIES FOR SENIOR MILITARY OFFICERS

INDIVIDUAL ESSAY

by

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ABSTRACT

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Few military officers have been taught how to effectively manage the money that they earn; the busier and more successful they become in their careers, the less time they have to do so. Today's ever-changing tax and military retirement laws, and unpredictable inflation, interest rates, and financial markets make it even more difficult to plan for their own personal financial future. To overcome these difficulties requires a comprehensive, personalized but easy-to-create financial plan of action. This publication provides the knowledge, tools, and framework for creating financial strategies which are oriented upon and appropriate to the requirements of senior military officers. Utilizing a building-block concept, and supported by appropriate planning forms, the reader is taken through a five-step integrated process: (1) Defining personal objectives; (2) Employing a variety of techniques to help protect assets; (3) Accumulating wealth through creating additional cash flows and investing in a diversified portfolio matched to appropriate risk-reward levels; (4) Establishing retirement and education funds; (5) Preserving current and future assets through tax and estate planning initiatives. This model permits the creative of a dynamic financial plan capable of focusing on goals and objectives which change over one's career and lifetime.

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FINANCIAL PLANNING STRATEGIES FOR SENIOR MILITARY OFFICERS

This effort has been unc... ..en because many senior military officers need personal financial planning assistance. As a professional body, very little time or effort is devoted toward planning for their own personal financial future. The nature of the profession, the extreme personal demands that work places on their time, the all-to-frequent moves, the inability to put down roots, extended tours in foreign countries, and a guaranteed form of compensation contribute to this planning void.

At the same time, it comes as a shock to many to realize that senior military officers are in the top 10% of all American wage earners. Many thousands of dollars pass through their hands during a military career. Yet, one wonders where those dollars have disappeared; why there aren't extra funds purchase those special things desired; why it seems difficult to save; why education costs severely strain their standard of living; and why there doesn't appear to be sufficient retirement funds to carry them through the "Golden " of retirement.

This pu...cation is to help prov' solutions to the above questions, and more importantly, help you take the fir... toward becoming financially independent. You are not promised excessive wealth; you will however,be able to manage better your finances, gain control over your financial future, and learn how to create successful wealth building strategies. The essential elements of this concept are based on the development and execution of coordinated plans reflecting your financial objectives and goals. To help in this effort are provided with the necessary forms and procedures to record and ... your current financial situation, and to use in developing your own personal financial plan of action.

By completing this plan, you will be able to accomplish the following:

- Assemble and organize your financial data and documents
- Calculate your present net worth
- Analyze your present income and expenditures.
- Project your future needs, income, and expenditures
- Identify your financial objectives and their priorities
- Analyze your insurance, education, housing and retirement situation
- Identify financial strategies for achieving your objectives
- Use projections to minimize your income tax, select appropriate investments, plan your retirement income, and reduce your estate taxes to a minimum.

What is **FINANCIAL PLANNING**, and how it can increase your personal wealth? It is composed of several components:

PERSONAL PLANNING

Determine your financial goals. What do you want 1,5,10 or 20 years from now?

INVESTMENT PLANNING

Reaching your financial objectives by utilizing your available resources to accumulate wealth for future needs.

TAX PLANNING

Diverting your tax dollars to areas of economic benefit for your family.

INSURANCE PLANNING

Understanding risk and preparing for possible personal and economic loss.

RETIREMENT PLANNING

Ensuring that you have enough tomorrow in today's dollars.

ESTATE PLANNING

Maximizing the property that passes to family members while minimizing the expenses.

KEY IDEAS TO WINNING THE MONEY GAME

Financial planning is a personal effort. You are different from any other person, you have different fina· ⁝ objectives, different assets, different personal situations and a different temperament to financial risk-taking. Because of these differences, only you can create, implement, and monitor your financial plan-a financial road map designed to get you from where you are to where you want to be. This plan will reflect an evolving, growing, changing process of adjusting your current financial situation to what you want it to be. It will not be change, but your reaction to it, that will determine your financial future. Only you can make it happen!

As we set out on this journey, it is important to know why others before you have either failed or have not found the "golden years" so "golden" after retirement:

. **Procrastination**-probably the greatest deterrent to reaching financial independence. *Time can either work for or against you.* With sufficient time, you will not need as large an amount of money to put to work. The less time you ha\ ‹ ˜he more money it takes. Start Now!

2). **Failure to establish your goals**-when you do not know where you are going, any road will take you there. Anything that can be conceived can be achieved; consequently you need to visualize your finan. ' goals now. This effort will help establish the basis for your plan, a plan whic becomes your blueprint for success.

3). **Failure to understand money**- you must understand that money should not be the central concern in your life, but that proper management of money is necessary to reach lifetime objectives, whatever they be. Financial know-how and a winning attitude is a definite aid while traveling through life's journey. It will require discipline, agility, the ability and willingness to make your money work hard for you. By the nature of our profession, we are

well trained to make hard decisions-all we need to do is add a degree of understanding of the true nature of money and what it must do to accomplish our financial goals.

4). **Failure to learn and apply our tax laws**-there are very few financial decisions which are immune to taxes. As military officers, we are affected by taxes: our salaries are paid from taxes, we pay considerable social security and income taxes, and we pay an indirect tax when our government spends more than it takes in, thereby driving up inflation and interest rates. We can however, minimize these impacts by knowing and understanding how to legally apply the tax laws to our economic benefit.

5). **Failure to keep accurate, updated records**- you need to both maintain and keep your financial records updated. Your tax returns, wills, and investment documents are important documents which you or someone else should be able to obtain without delay.

6). ***Failure to keep your knowledge of investments alternatives up-to-date***-the advent of the computer and deregulation efforts of the Reagan Administration has created more complex investments over the past five years than during the preceding 50. Because of these dynamics, yesterday's best investment could be today's worse. You must either stay current with your investments or have someone do it for you.

THE SECRET FORMULA FOR SUCCESS

To offset these failings, let me share a very simple formula for the accumulation of wealth. This secret (only because so few practice it) runs through everything found in this publication:**"A PART OF ALL I EARN IS MINE TO KEEP"**. Yes, you share your earnings with the government, the bank, the mortgage company, and the church. The real question is where do you stand in the line-at the head where you belong to receive your share first, or like so many others, you've put yourself at the end of the line, trying to save what

is left over, and wondering why your share continues to get smaller.

The second part of this formula is to realize that there are only three sources of income: the first i r work, however, you will retire someday. The second is your money at work. Here is where you have the opportunity to reach financial freedom. The only way to obtain financial success is to pay yourself first so that your money is at work for you full time. The third way is charity, not a viable solution.

THE NATURE OF MONEY-HOW MUCH IS NEEDED?

If paying yourself first is the ke ine how much money is needed to retire financially independent. The answer depends on the standard of living you wish to maintain, the number of years before you retire, the amount of inflation you suffer and your ability to put some of what you learn from this publication to work. The following table can be used to determine e amount of additional income needed at retirement given various inflation rates. To make the calculations, subtract your current age from the age in which you expect to retire to obtain the number of years to retirement. Read across the top to find the rate of inflation you feel safe to assume.

Years to retirement	Inflation 3%	5%	8%	10%	12%	15%
5	1.16	1.28	1.47	1.61	1.76	2.01
10	1.34	1.63	2.16	2.59	3.11	4.05
11	1.38	1.71	2.33	2.85	?.48	4.65
12	1.43	1.80	2.52	3.14	[illegible]0	5.35
13	1.47	1.89	2.72	3.45	4.36	6.15
14	1.51	1.98	2.94	3.80	4.89	7.08
15	1.56	2.08	3.17	4.18	5.47	8.14
20	1.81	2.65	4.66	6.73	9.65	16.37

For example, assume that you would need $3000 per month if you were to retire from the military today, that you are 45, that you plan to work until age 65, and that you feel that inflation will remain at 5%. To find the amount you would need per month in ? years to obtain the same purchasing power as you do today with $3000, multiply $3000 by the factor of 2.65 = $7,950.

If you need $8000 per month at age 65 to maintain your current economic status, how much will you need to accumulate prior to your retirement? To calculate this amount, divide your assumed rate of return into 12, and then multiply your answer by the monthly amount. For example, 12 divided by a rate of return on your money of 12% would give you 100 x $8000 = $800,000. At an assumed 8% return, your goal would be $1,200,000 (150 x $8000). If $800,000 is required at age 65, how much would you need to invest each month with a 12% annual return: $1,065. If you start at age 40 vs 45, you reduce the required amount to $715. As you can see, time and the rate of return is a very powerful ally in accomplishing your goal.

The importance of these two variables can be easily demonstrated in the following matrix. With a lump sum of $10,000 invested at 6% and 12%, look at the difference time and the rate of return makes on your investment:

YEARS	6%	12%
10	$17,908	$31,058
15	$23,965	$54,735
20	$32,071	$96,464
25	$42,918	$170,000

What is represented on this matrix is the key to financial independence. It can be stated in the following formula:

MONEY X RATE OF RETURN X TIME

To further demonstrate this concept, there are tables in the annex which reflect the results of putting your money to work for yourself as hard as you had to work for it. To become financially independent, you must save and let your money grow over time at the highest rate possible commensurate with the level of risk you are prepared to accept. Please review these tables and work through several "what if" examples as this will help you better understand this concept. The figures on each table can be adjusted to fit various levels, i.e. $1,000, $1500, $3000, etc.

RULES TO REMEMBER

The RULE OF 72:

This rule gives you the to the question of how long it will take to double your money- to make $1 become $2- at various rates of return. Divide 72 by your selected rate of return, say 12%, therefore your money doubles in 6 years. Likewise, to double your dollars in 5 years will require you to earn 14.4 percent yearly (72 divided by 5).

THE RULE OF 116:

This rule tells you how long it takes to tr your money. Divide the rate of return into 116. For example, your money will triple in 9.7 years with a 12% annual return; 14.5 years with an 8% annual return.

WEALTH BUILDING STRATEGIES

1) Understand and avoid the reasons for financial failure.

2) Memorize and employ the key to financial independence:

MONEY X RATE OF RETURN X TIME

3) Pay yourself first-Always!

4) A easy rule for calculating earnings on money: Rule of 72 gives you the answer of how long it takes to double your money. If you know the annual yield, divide it into 72. If you know the number of years required for doubling your money, divi it into 72 to obtain the yield.

SECTION I

DEVELOPING THE FINANCIAL UMBRELLA

Financial planning has different meanings for each of us. This is basically true because of our individual views of money and what it stands for, our economic backgrounds, our risk acceptance levels, and concerns for financial security. While recognizing that each of us differ; we can present a financial model which will be applicable to all but the most unusual military officer.

This model has been developed over the past ten years of active involvement with fellow military officers while assisting in the development and initiating of their financial plans. The model is successful because it focuses on the specific objectives within each segment of the financial planning process. It starts with the basic needs level and progresses sequentially through higher requirement levels. This approach enables us to consider and fit specific solutions to specific needs in a coordinated and integrated manner, resulting in the creation of a tailored plan for implementation.

In developing this model, we begin by examining the decision-making process which can be used at every level of the financial umbrella. In arriving at personal financial decisions, keep these questions in mind:

1) What is your objective?

2) Do you have the necessary facts to make a sound decision?

3) What are the alternatives?

4) Have you chosen the most profitable alternative?

Our financial model for building financial independence is based upon the following umbrella of financial requirements and goals:

	PRIORITY NEEDS	GOALS	PROGRAMS AND INVESTMENTS
1.	Short Term	Cash Liquidity/ Emergency Funds	Saving accounts/Money Market Funds
2.	Insurance	Risk Protecti	Life/Medical/Home/ Auto/Liability
3.	sset Accumulation	Accumulation of Ca... and Current Income	Long-term Capital Appreciation; Growth-Income (Growth/Total Return and Bond Funds)
4.	Future Asset Requirements	Preservation of Capital and Income for Retirement, Education,Travel, etc	High Yield and Total Return Funds and Bond funds (IRAs, Bond & Total Return Mutual Funds, UGMA, Trusts)
5.	Estate Planning	Passing Assets to Others with Minimal Expense	Wills/Trusts/Gifts to Minors/Gifting/Charity
6.	Speculative Investments	Turn Tax Dollars into Capital Gains/Rapid Capital Appreciation	Tax Shelter Investments Options/Commodities/ Currencies/Collectibles

One can see from this model that we actually work through the entire financial life-cycle. We focus initially on the need to create emergency funds and provide for risk protection over ourselves and our assets. We then begin to accumulate assets for current and future needs. As we learn later, we have the options of acquiring a given amount of wealth by means of either positioning current assets for appreciation, converting cash flow into assets, or both.

Next, we preserve our accumulated wealth by conserving and protecting the buying power of, or the income produced by, this wealth. We do this by concentrating on reducing our exposure to unnecessary risk by adjusting our portfolio.

Finally, we enter the phase of distributing some financial achievements to family members and/or others. As we will later see, we must take care not to create more problems for the future than are being solved today by this distribution.

As you work yourself through each of these phases, it is important that you begin to think in terms of:

Available assets and how they are positioned, taxed, and risk-managed; and future income (cash flow) and how it is directed, taxed and protected.

The importance of thinking in these terms becomes clear when you recognize that your financial future will depend not only upon how you position your current assets, but also how you create and then direct additional cash flows. At our current stage of life as military officers, wealth accumulation will depend far more heavily upon properly allocating annual cash flow than upon the positioning of existing assets. For the majority of us, the most important financial task is to: **PAY YOURSELF FIRST!!**

Within each of these two segments, assets and investable cash flow, we can suballocate funds to a variety of specific areas. A certain subsegment might have absolute safety of principal as the primal objective; other subsegments will seek stability of principal and income; others will seek growth of income or capital. What is important to understand is that our assets and investable income satisfy a multitude of varying objectives. Each element exists to support and satisfy a specific requirement. That requirement is determined by the investment objective, which in turn is based on the risk level that is attached to it.

Wealth building through the model requires that you understand these principles. They will become clearer and have more meaning as you work through this publication.

WEALTH BUILDING STRATEGIES

1. Understand the Financial Umbrella Model

2. Know that wealth is created by:

   -Positioning of current assets

   -Creating future income (cash) flow

3. [illegible]r most important financial task:

   PAY YOURSELF FIRST!

SECTION II

GETTING STARTED- YOUR FINANCIAL HEALTH CHECKUP

The first step in developing your financial plan is to give yourself a financial health checkup. As a beginning, find out where you stand today and prepare a long-range projection for tomorrow. To aid in this process, it will be easier if you bring together all the information you need into a single location. Annex A lists files that a military family should maintain. As you begin to accumulate these, ensure that originals are always kept in a secure and known location.

To conduct your checkup, Forms 1 thru 10 in Part II, are designed to cover the pertinent areas required to know where you stand financially. Each of these forms is designed to fill a specific need. The starting point for you, after recording your basic information, is to determine your net worth. Forms 4 and 5 calculate your present net worth, make "what-if" projections, evaluates your assets and liabilities. Forms 6 thru 10 permit you to analyze your income and expenditures to determine the income available for investment and meeting of other goals. Please work through these forms now.

Once you have completed these, let's examine some potential opportunities for creating investment dollars:

1. How much of your earned income is left for future goals and for investment? The norm at which we should start is 10-15% of your earned income. You can increase the amount available for investment by decreasing your spending or increasing your investable cash flows.

2. When will you receive a promotion or a raise (longevity or annual)? Does your spouse work, full or part-time? Can she increase her earnings?

3. Are you paying more than 35-40% of your employment income for federal income tax? If so, you need to do something to reduce the tax bite.

4. Does the combined percentages of your basic lifestyle and discretionary expenditures amount to more than 70%? If so, and you earn more than $50,000 (LTC and above), it is likely that you could reduce your expenditures without seriously reducing the quality of life, utilizing the difference for investments.

FAMILY BUDGETS

The answers to these type questions give you a starting point in determining how valuable a budget will be to you. The objective of any budget is to help accomplish your goals by controlling your uses of money. Used wisely, it identifies and frees up investable cash flow; it helps save for the luxury items which you or your family deserve; it helps you live within your income (earned only, hopefully) by planning ahead; it helps you make long-term plans for accumulating assets; and it helps maintain a record of tax deductions.

For the majority of officers, a budget should be treated as a loose guide to spending. It should reflect your unique habits and preferences but it shouldn't become a restrictive, inflexible month by month financial tool. The important issue is to determine if you are, in fact, living within your means and that you are honestly paying yourself first a portion of your earnings each pay period.

One question which is frequently asked by married officers with working spouses is, how to handle a budget? A suggestion is to create separate personal accounts but joint checking account to pay all bills. If you, however elect to use only a joint account, insure that each of you is allocated a small amount of "mad" money for your private use. Others may want to pay all bills from one salary and save the other. The important issue is to have an agreed-upon plan.

To preclude the drudgery of manually handling the budget, there are several excellent computer software programs which you should investigate if computers fit into your life. Good budget books are also readily available.

MAKING ENDS MEET

For those officers who are having difficulty making ends meet, the problem probably lies with uncontrolled and unprogrammed spending-not planned expenditures. A suggested solution is to establish a dedicated expense account which is designed to create more discretionary cash flow. First, identify those expenses which always seem to come at the wrong time or in the wrong budget account. Divide this amount by 12 and then at the beginning of each month, deposit this amount into this expense account which is carried in either a money market or financial management account. Checks are written only as needed to cover these expenses so that all excess cash is drawing market rate interest. This account can also be used to accumulate funds for major or emergency expenditures. The value is apparent: your excess cash is working full time earning interest, plus permitting the accumulation of discretionary cash flows to handle any unprogrammed expenses which could "burst" your otherwise balanced budget.

WEALTH BUILDING STRATEGIES

1) Give yourself a financial checkup to get started toward financial independence using Forms 1-10 in Part II to get started. Be honest with yourself.
2) Establish a flexible budget to give you financial direction.
3) The start toward financial independence is to PAY YOURSELF FIRST!
4) Identify from your analysis preliminary amounts of available cash flows for future investment purposes.
5) Understand the principles and concepts of the financial planning model as we are ready to put them into action.

SECTION III

HANDLING SHORT-TERM MONEY NEEDS

The foundation of any financial plan is the creation of an accessible saving and emergency fund. The importance of such a fund necessitates its being discussed separately from other investment options. The benefits of this fund are many:

1. It helps maintain a balanced budget over time.
2. It removes the financial burden resulting from incurring large, unexpected expenses.
3. It allows you to enjoy opportunities which you might otherwise have to pass up.
4. It provides the means to accumulate cash flows necessary to meet your financial goals.
5. It gives you peace of mind by ensuring the availability of emergency funds

The establishment of a short-term fund is essential to your future financial health. As such you should give consideration to placing these funds where you satisfy three key investment characteristics:

SAFETY

LIQUIDITY

YIELD

These considerations today usually point to liquid and safe money-market mutual funds and money-market deposit accounts from banks, credit unions and savings and loans. While varying somewhat in yields, they all offer similar characteristics. They fluctuate minimally in price, if at all. They are liquid, they offer known yields, they can be obtained without fees, and generally they can be opened with small deposit amounts.

Their liquidity, predictability, simplicity, accessibility, and low cost make these investments ideal for the saving portion of your portfolio. Still, they have some important differences which you should understand.

First, passbook accounts and some money market funds have no minimum for initial or subsequent investments. Most money-market funds however require $1000 to $2500 initial deposits with $100 to $500 subsequent investment minimums. With deregulation taking full effect in 1986, each bank, credit union, and savings and loan can basically set its own interest rates. Generally, the rates these institutions will pay will be 1/2 of one percentage point below money market funds. Rates will vary between institutions as will the minimum investment required to open an account. It is important to determine the interest rate you will earn if your balance drops below that figure, as the difference can be substantial. Money Market funds pay the same rate no matter how much you keep on deposit.

While you are evaluating the question of interest rates, always, always determine the method the institution uses to calculate your interest. If it is not compounded daily, on the daily balance, go somewhere else. Be especially careful of the terms of any superNOW account. Generally, they now yield about 1-1.25% less than a money market fund plus often charge monthly service fees.

Short-term Certificate of Deposits (CDs') or Treasury bills are normally good candidates for satisfying your short-term needs. They are insured up to $100000, are issued with no commissions or fees, however a substantial penalty is levied if you withdraw your money before maturity.

For those unfamiliar with money market funds, it is a special type of mutual fund which pools the investments (deposits) of many individuals and reinvests them in very short term "money market" securities. Money funds are not banks. They operate like banks in that they take in money (deposits) and

then make loans to businesses, governments, and other financial institutions.

The table below summarizes the basic differences between money market accounts offered by savings institutions, and money market mutual funds:

	BANK	MONEY FUND
Fed. Government Insured	Yes	No
Highest Yield	Rarely	Usually
Check Writing Restrictions	None	Some

Deposits at most banks and savings and loans are insured up to $100,000 by an agency of the US Government, while money market fund investments are not. On the other hand, money funds will pay you the highest current market rates of interest on your savings while banks adjust their yields to their cost of money. Both money funds and banks offer checking privileges, with money funds generally having a $250 minimum but no service or checking charges.

Which is safer? There has been no financial difficulty with money fund. One can not say the same for the banking institution, even though the US vernment provides the backing and solvency necessary to protect bank accounts. In essence, bank depositors give up some of the interest earned on their money in exchange for the government absorbing practically all the risk. Money fund depositors receive all the net interest earned with their money, but also take all of the risk.

You can eliminate practically all of the risk in money market funds by investing in funds which either hold all government instruments in their portfolios or which are sponsored by major brokerage or insurance companies.

HOW MUCH IS NEEDED?

The next question deals with the amount of funds which should be in your short-term account. The total amount will obviously vary according to your current r-term situation, however as a minimum, all officers should keep of three months take-home salary in these accounts. The best

way to help pay yourself first and ensure that all of your dollars are working hard for you is to allot a portion of your twice-monthly pay to either a money market fund or to a financial institution. Twice-monthly should be selected because you give up the equivalent of three months interest on your pay if paid only at the end of each month.

WHERE TO INVEST YOUR SHORT-TERM MONIES?

Since we are dealing with investments which orient on the elements of safety and liquidity, we do not gain anything through diversification. Consequently, effective management of this portion of your portfolio calls for you to consolidate these investments in one or two places. When you need to draw on these savings, having them in one location and investment vehicle makes it easy to gain accessibility to the funds. This consolidation also makes it easy to move them into other investments.

The best short-term investment is a high-payout money market fund combined with an interest paying checking account from a credit union. As you pay yourself first each pay period, use the money market fund to hold these funds, replenishing your checking account as needed. When the minimum level of three months take-home salary is reached in your short-term liquidity account, begin to transfer these excess funds to other segments of your financial plan. We will cover the techniques for making these decisions in later sections.

CASH MANAGEMENT ACCOUNTS

An alternative to the above recommendation is to make use of what is known generically as a "cash management account" (CMA). These accounts are offered by the majority of investment and security firms and go by many different names- Total Assets, Reserve Cash, Money Management plus Gold, Active Assets, Money Plus, Schwab One, etc.

Regardless of what they are called, they function much the same, providing a means of tracking one's monthly cash flows. The basic features are:

- a choice of taxable or tax-free money market funds. Most will also have a "government-only" money market fund for extra safety.

- a debit or credit card, the most common being VISA.

- Check-writing privileges, some with minimum amounts.

- Annual fees to include charge cards of $50 to $75 a year.

- A daily sweep of any free balances in the account automatically into the supporting money market fund, earning daily interest. Some accounts only sweep when balances reach a certain level, usually less than $1000.

Minimum balances will again vary between accounts, ranging from $1000 to ?0,000. Canceled checks are returned by about half of the accounts.

Probably the most important advantage to you would be the receipt of a comprehensive monthly statement, providing a detail summary of the month's transactions and earnings. Some statements even breakout expenses by codes to help track them by category and by method of payment, i.e., check or credit card.

If you determine that you need the structure that a CMA provides, be sure to check out what the specific account will do for you and what the cost are. There are many advantages, however the cost will exceed that of regular checking accounts.

In summary, the WEALTH BUILDING options for satisfying our short-term cash liquidity and emergency fund requirements are

INVESTMENT VEHICLE	SAFETY	LIQUIDITY	YIELD
Bank money accounts	Excellent	Good	Good
SuperNow accounts	Excellent	Good	Fair
Money Market funds	Good	Excellent	Good
Cash management accounts	Good	Excellent	Good
ificate of deposit	Excellent	Poor	Excellent
sury Bills	Excellent	Excellent	Good

SECTION IV

LIFE INSURANCE-UNRAVELING THE MYSTERY

There are many reasons which life insurance policies are sold to consumers. There is only one reason why they should be bought: To provide financial protection in the event that you die before accumulating the resources required to meet the future financial needs of your dependents. When accept this approach, you begin to understand the true meaning of the term "life insurance". In essence, you should be buying "financial protection for your dependents" and not simply "insuring" your own life.

Your insurance needs will vary over your lifetime as income and responsibilities fluctuate and as your personal investments grow. Without children, insurance requirements are not great. Children and house mortgages mean increased responsibilities and a corresponding need for insurance protection. As children near college age, insurance needs normally reach a maximum. After the children graduate and/or leave home, the need for insurance will normally decline. By the time one reaches the mid-60's, insurance should not be a big factor.

In general, all life insurance policies say the same thing: In return for premiums duly received, the insurance company will pay the face amount (the promised benefit) of the policy to the named beneficiary upon receiving proof of the insured person's death. The death benefits are paid out quickly and are not taxable to the beneficiary.

To assess whether your present life insurance coverage is adequate, inadequate or excessive (yes this is possible), you have to envision the needs and resources of your dependents in the event of unexpected death. Which dependents, if any, will require financial support? When will they need it,

how much will they need, and for how long? What income will be available from other sources? How much income will the proceeds of life insurance have to provide to maintain the expected standard of living?

DO YOU REALLY NEED LIFE INSURANCE?

As mentioned above, the only purpose for insuring your life is to provide income for your dependents after your death. Therefore, the first question to ask yourself is, "Do I have any dependents for whom I should provide after my death?"

There may be none, and therefore little or no need for life insurance. Or there may be a marriage where both are working and all children are married. Other than for personal reasons, there may be little or no point in providing a safety net of life insurance. However, if your spouse, children and/or parents depend upon your earnings, you may need to insure your life quite heavily.

As officers on active duty, the level of insurance provided to us by the Government will terminate upon retirement. At the same time, you have the option of reinsuring yourself through the Survivors Benefit Plan. This factor, plus the job skills of your spouse, the availability of insurance from a second career, and the level of investment assets need to be considered in making a review of your insurance needs.

Don't be pressed into buying what you don't need- Factors such as buy now to get a lower rate, to insure your financial future, or to offset the risk of insurability at a later time should not cause you to throw money at more coverage than you need. It is far better to devote these funds to an aggressive savings and investment program with the objective of becoming self-insured if you live to an old age. The odds are that you will.

HOW MUCH DO I NEED?

Life insurance is concerned with and based upon the economic value of a human's life. In determining the amount of life insurance required, there are two basic approaches: 1) the human life value approach and 2) the needs approach.

The first approach involves the capitalization of the individual's earning capacity, that part of the current earning power of the individual that is available for support of his or her dependents. This approach takes an individuals' net income, say $40,000, the difference between his current age (say 45) and when he expects to retire, say 65 and discounts the net income at an assumed rate of interest-say 12% for this time difference. At 12 percent, $1 per year for 20 years is worth $9.6463 today. Thus, $40,000 times $9.6463 equals $385,852, representing the present worth of capitalized earnings and the amount of income which requires replacing. In the Annex are tables of present and future values which will allow you to do "what-if" analysis utilizing this concept.

Another approach which is more practical is to examine the various needs that would be experienced by the family in the event the breadwinner should die. While the needs will vary from family to family, certain categories of needs can be established which are applicable to most families:

- Cash to pay immediate obligations
- Money to pay the mortgage
- Money for education expenses
- Cash to cover living expenses

Immediate expenses that will arise at death simply did not exist before. Cash is required for funeral expenses, for current bills, for an emergency fund and possibly for probate and estate taxes. An emergency fund is required to cover living expenses during the period when the estate is being settled.

If you had not fully funded your short-term cash account as recommended in the previous section, there may not be enough liquid assets available to your survivors to take care of the cash requirements in the first months following death. If death occurs on active duty, a death gratuity of $3000 maximum is paid, however this amount will generally not suffice for long.

The majority of officers will have one or more mortgages which will leave their families indebted to a financial institution. Whether the mortgage is immediately paid off, or paid from rental/investment income, it may be important for the peace of mind of the survivors, to have sufficient money available to clear your home or rental properties of debt. If the existing mortgage interest rate is low (9-10 percent currently) the survivor should consider keeping the mortgage because they should be able to invest the insurance proceeds at a higher level of return. Obviously, tax considerations must be incorporated into this decision.

Education expenses, like a mortgage, can be paid from investment income, however your children may find it reassuring to have a special fund set aside for these purposes. The amount of this fund will depend upon several factors: the child's ability to earn all or part of his expenses; the type of college; length of education; availability of scholarships; and your desire to provide support to your children if you die.

The level of living expenses raises the fundamental question of how well the family should be provided for. The majority of us would like for them to maintain the standard of living to which they are accustomed. There should be a reduction in the amount of expenditures required to maintain this standard of living as many of the normal expenses are eliminated. Generally, if the mortgage is paid off or paid from the separate mortgage fund, the surviving spouse and children will need about 60 percent of the gross income that the family needed when it was complete. If the mortgage payments are part of the

general living costs, then they will need closer to 80 percent of the complete family's gross income.

While no one can set a precise figure on how much life insurance is required, primarily because no one knows when you are going to die, the above categories give us a starting point. Utilizing the following spreadsheet you determine your life insurance needs. The rate of return on line 9 is representative of high yielding mutual funds over the past 10 years. You may wish to vary the yield percentage to reflect your own expectations.

	EXAMPLE	YOUR FAMILY
1. Funeral expenses	$5,000	________
2. Extra, one-time debts	1,000	________
3. College fund	40,000	________
4. Total	$46,000	________
5. Annual living expenses (Current family gross income($40,000) X .80)	$32,000	________
6. LESS: Spouse's income (SBP/DIC included)	$15,000	________
7. LESS: Dependent child's Social Security benefit	$3,000	________
8. Total annual living expenses(5-7)	$14,000	________
9. Divide Line 8 by assumed investment return of 10%	$140,000	________
10 Add Lines 4 and 9	$186,000	________
11 LESS: Savings and investments	$30,000	________
12 ESTIMATED INSURANCE REQUIRED	$156,000	________

Recognize that this estimated total will be further reduced if an officer dies on active duty or as a result of military related causes because of payment of Servicemen's Group Life Insurance coverage (max of $50,000).

TYPES OF LIFE INSURANCE

There are three basic types of contracts issued to insure individual lives: whole life, term, and so called flexible policies.

WHOLE LIFE

An ordinary whole life (or straight life) policy provides insurance protection by the payment of a fixed premium throughout the lifetime of the insured. In return for this lifelong protection, the insurance company will charge you premiums which will start high, but will stay the same as you get older. The company, in effect, averages out the costs of carrying you over a lifetime by over-charging when you're young and under-charging when you're older.

Besides providing protection, a whole life policy also builds up a cash value, an amount which you can borrow against or redeem by cashing in your policy. After the first policy year, the accumulated cash value may also be utilized to purchase paid-up or extended term insurance. This is the most common type of insurance help by American families.

The advantages of this type of policy are the level amount of premium payments over the life of the policy and tax deferred accumulation of cash values. Any dividend payments are considered premium refunds by the IRS and therefore are not taxable.

Ordinary life may be purchased on a guaranteed-cost or a participation basis. A participation policy, while higher in initial cost, pays dividends that may then be applied toward the premium payments. The insured can also convert the policy to a paid-up one with lower value but not requiring additional payments.

A form of whole life is a fixed-payment policy. This type of policy provides insurance protection throughout the lifetime of the insured by the payment of a fixed premium for a period of twenty or thirty years. At the end of this period, payments cease, but the insurance continues in force, with guaranteed values continuing to accumulate. Premiums for the twenty-payment life policy are higher than those of either ordinary life or thirty-payment life.

These type of policies can be tailored to the individual's needs, designed to mature either at a specific time in the future or at an specific age. They have the advantage of being paid up at a definite time and of building cash values more rapidly than does a similar amount of straight life. The major disadvantage is cost, with other policies providing more protection for the same amount of premiums.

There are several serious problems with whole life policies which you should understand. First, a life insurance policy purchased today will be worth a mere fraction of its original value when its benefits are needed- price inflation over the years robs much of its purchasing power. As a result, such a policy could fail to yield the buying power it was intended to provide. In other words, even though inflation is today at a 3-4% level, over 10-15 years at these low levels, $100,000 will not provide the amount of protection you expected. Given this, to purchase the amount truly needed will require a much higher amount than expected and because of cost, will require you to be a prudent buyer.

Second, with whole life policies, the insurance company never pays to your beneficiaries more than the policies face amount, even though there may be a large cash value amount. The insurance company, in essence, uses the cash value amount to reduce its risk to less than the face amount of the contract. You can borrow the cash value or receive it if you cancel the policy. If you

die before your given life expectancy, the company will still pay you, in total, only the face amount, even though part of the face amount has been earned by you through previous premium payments.

Third, whole life policies are not credited with enough of the interest being earned on the cash value funds. The insurance companies earn approximately 8-12%, yet credit your account with only a portion of this amount, generally 4 to 5 percent. You do better with money market or credit union accounts.

TERM INSURANCE

Term life insurance protects you for a specified period of time. If you do not die during the term period, the policy will expire without value. Term policies are ideal for providing a large amount of protection for a limited time at the lowest cash outlay.

By paying an additional premium, term policies can be made renewable or convertible to whole life or both. If the policy is renewed or another term policy replaces it, a higher premium is charged because the policy holder is [illegible]r and has a greater chance of dying than in the previous period. As [illegible] needs of a family change over the years, term insurance allows you the flexibility to adjust to those changes. It also reduces the loss in purchasing power due to inflation due to its pure cost structure.

There are three basic forms of term policies:

-Annual renewable term provides the same level of protection each year, however the premium increases each year.

-Decreasing term permits the premium to remain the same but the level of protection decreases.

-Level term provides for the face amount to remain the same for a chosen period of time- 5,10, 15, years, etc. or until you reach age 65. The

premiums remain level throughout period. You should ensure that the policy is, in fact, renewable to preclude problems if you suffer any serious health problems. The renewable feature precludes the insurance company from not renewing due to your health conditions. SGLI is a form of level term as it has constant premium rates and limits protection for the period of time we remain on Active Duty. It is also renewable when you retire through a conversion to a VGLI policy.

FLEXIBLE LIFE INSURANCE

This type of policy is a recent addition to the life insurance industry. It allows the insured to have a wider range of options than permitted under either whole life or term policies:

1. You purchase both term insurance and a tax deferred cash build-up account with options to change the proportions to fit your changing circumstances.
2. You can raise or lower your premiums.
3. You can increase or decrease the amount of coverage.
4. You earn tax deferred money market interest rates or equity appreciation from stocks, bonds, or mutual funds. These are not guaranteed rates or returns, so there is some risk associated with this portion of the policy.

These types of policies are gaining in importance within the life insurance business. Both Universal life and Variable life allows for the insurer to gain the equivalent of buying the cheapest insurance policy-term-and investing the difference in either money market instruments or into the equities markets through stocks, bonds, and mutual funds. The flexible premium feature lets you tailor your policy to meet your changing financial status. You can reduce, increase, or make lump-sum payments to the policy as well as adjust your coverage levels.

One should not forget that the primary purpose of buying a life insurance policy is for the insurance protection; the cost of that portion should be a

primary consideration. Flexible life policies offering an initial high rate of return on the cash value but charging a high price for the insurance element, excessive cancellation, and/or administrative costs should be avoided. The effects of high fees and company expenses can be significant, reducing the advertised gross yield to a much smaller actual return.

A TAX STRATEGY

A tax strategy which makes the Universal Life policy attractive because of favorable tax treatment involves withdrawals and borrowing from the policy. You can withdraw the principal (the sum of your premium payments) free of any taxes. If you need additional funds, don't draw from the build-up cash value because you will be taxed on it as ordinary income. Rather, borrow from the policy. The company will charge you approximately 8 percent, however you will still earn interest on the remaining funds in the cash value account. Generally, the portion credited will be reduced to 4.5 to 6 percent. The sum of this effort will generate you tax deduction for the 8 percent interest charge, the money you've borrowed is tax-free because it is a loan. Currently, you can invest it in taxable bond funds yielding 10-12.5 percent. The 4.5 to 6 percent interest you continue to earn on the policy is tax deferred as it is being paid into the insurance policy. You could wind up with a 6.5 to 10.5 percent profit after taxes.

SELECTING THE RIGHT INSURANCE COMPANY

There are thousands of life insurance companies, all interested in providing you some form of coverage. Given our profession and particularly those of you who truly engage in specialized and hazardous tasks, it is important to provide financial protection for your dependents from companies who fully understand these risks. Selecting the one that is right requires evaluation of three important factors:

-The financial strength and integrity of the company

-Service

-The cost of the policy

Life insurance involves a long-term financial commitment, so you should be concerned about the company's ability to fulfill its obligation to you whenever it is called upon to do so-tomorrow or 50 years from now. The A.M. Best's Insurance Report is the industry bible, rating all insurance companies who do business in the United States. There is only one guideline - buy only from the top rated-those with a A+ rating. There is no need to go below that level.

Because of our mobility as a profession, service is important whether you are dealing with an agent or directly with the insurance company. The best source for determining the level of service is by asking questions of the agent or company. Also ask for a proposal and a sample policy-one of the keys is how the policy is written- do you understand it?

Cost should be the most important factor in deciding from which company you will buy insurance. There is as much variety in cost for like policies as there are companies. Each has its own cost structure. Each company should be able to provide you with two indexes- the net payment cost index or the surrender-cost index. Lower cost index numbers indicate lower cost companies. The best index to use is the net payment cost index. In comparing policies, like policies must be compared.

SETTLEMENT OPTIONS

There is only one time that you should not select a lump-sum payment of proceeds. That is when the beneficiary is totally incapable of managing the proceeds and there is no one available who is knowledgeable and trustworthy. Ordinarily, the beneficiary can earn a greater rate of return through personal investments than by leaving the proceeds with the insurance company. Simply

placing the proceeds in either Municipal tax-free bonds, Bank CD's, Treasury instruments or high yielding no-load mutual funds will generally produce greater total returns. Don't believe either the agent or the company who state that they can provide you with professional and tailored investment management. They may, but at a cost! Taking receipt of the funds will allow the family to establish the dedicated funds cited earlier for living expenses, mortgage, and education costs.

FAMILY RIDERS AND OTHER PROVISIONS

With the exception of family riders on extremely low net payment cost term policies, the prudent insurance buyer should not pay premiums for life insurance coverage on the life of his dependents. In the majority of cases, the additional funds expended on such protection would be better applied toward more insurance on the primary income earner's life.

As stated, the purpose of life insurance is to provide some level of ancial benefits to one's survivors who are dependent upon the insured for lly, there is no reason to insure the life of a child, unless there is a question of insurability at a later age. For the officer who can afford sufficient insurance, accidental death benefits are unnecessary, primarily because war related deaths aren't covered. Waiver-of-premium provisions may sometimes be desirable if military restrictions don't apply. The same applies for guaranteed insurability and cost of living riders. Check the proposed policy carefully.

ON DISCONTINUING OLD POLICIES

Whenever you consider discontinuing a policy, it is generally wise to consult with a representative of the company to see if there are special provisions of the old policy that are not immediately evident or if the policy can be swapped for one with a newer and better mortality table (1980 Standard

ordinary Mortality table should be utilized), or with increased cash earnings on the investment portion of the policy. This exchange is particularly recommended if you hold nonparticipating permanent type policies issued during the early 1960's, primarily because of their unsuitable to cope with inflation, and their excessive premiums due to use of old mortality rates.

GOVERNMENT PROGRAMS

No discussion of life insurance would be complete without incorporating the many programs of the US Government to which we as military officers are entitled. Some of these programs affect us during our active duty tour while others either carry over or commence at time of retirement. The difficulty of adequately discussing the specifics of these programs is that the rules are seemingly being changed by Congress. At this writing, questions exist over Cost of Living Allowance (COLA) annual adjustment for inflation, retirement benefits and computation rules, and inflation adjustments to Survivor Benefit Plan (SBP). Consequently, it becomes quite important that each of us continue to follow these events and adjust our plans as Congress changes these programs. We can focus on some of the more relevant programs as they now exist and provide suggestions on how to best utilize them to our financial advantage.

In evaluating our life insurance requirements, several programs help to offset any gap that exists in providing the level of protection required. First, the Servicemen's Group Life Insurance (SGLI) program has been increased by Congress to a maximum of $50,000. We are automatically covered at this maximum level unless there is a request, in writing, that coverage be canceled or reduced to a lower level, a step which is unthinkable! The key issue with SGLI is to ensure that you have the correct individual(s) designated as the beneficiary. You should, like all other insurance, request proceeds be paid in a lump-sum amount.

Coverage under SGLI continues for 120 days after separation from active duty. You have the option of continuing the same level of coverage under SGLI by initiating a Veterans Group Life Insurance (VGLI) policy at time of retirement. This policy is a five-year, nonrenewable, term policy issued in incremental amounts of $5,000, up to a maximum of $50,000. The cost of approximately $17.00 a month for the maximum coverage is the best insurance value obtainable at your retirement.

If you die while on active duty or from service connected causes (determined by the VA), certain survivors of the veteran are eligible to receive Dependency and Indemnity compensation (DIC) payments. The rate is determined by the grade of the deceased service member. Current DIC payments are $665 for O-3's; $703 for O-4's; $775 for O-5's; $873 for O-6's; and $944 for O-7's. Additional amounts of $55 are paid for children unmarried and under age 18 or age 23 if attending school. Payments are also made to dependent parents under certain circumstances. DIC payments are not taxable income to the recipient. DIC payments are adjusted periodically by Congress, however there is no annual adjustment for inflation. DIC is not tied to any kind of an earnings test, therefore it is payable to your widow regardless of other income. The amount of DIC paid is, however, deducted from the SBP payment if you elect to have your dependents covered by this program. This deduction occurs automatically if you die while on active duty.

The Survivor Benefit Plan (SBP) has a very direct affect on a service member. and his dependents, especially at the time of his retirement. The significance of this program becomes clear when one realizes that all benefits which your survivors would receive if death occurred while on active duty, with the e[illegible]n of Social Security, are lost, or placed in question, upon your reti[illegible].

DIC, mentioned above, will not be paid for death during retirement unless the "cause of death" can be attributed to a service connected condition. The question of SBP selection further compounds itself for the surviving spouse when the youngest child reaches age 16, because her Social Security payments are suspended until she reaches at least age 60.

SBP was created by Congress in 1972 to provide an annuity for your dependents to cover both the Social Security gap and to help the spouse maintain a reasonable standard of living. There are many rules affecting payments and eligibility criteria. For our purposes, you should know that you are automatically covered by SBP if you are on active duty and eligible to retire. If you died on active duty your monthly SBP payments would be computed at 55% of your retired pay. For an O-6 with 30 years, this amounts to $1839; for an O-5 at 20 years, $967. At the time of retirement, you will have to make the choice of enrolling in the program or refusing it. We'll cover that aspect in the section on retirement planning.

As indicated above, the basic objective of SBP is to provide up to 55% of the retiree's retired pay to his/her spouse for her life. You may select any amount from $300 to your full retired pay for coverage. The cost for spouse-only coverage is $7.50 for the first $300 of the base amount plus 10 percent per month of the remainder of the base amount. This amount is deducted from your monthly retired pay and is not included in your taxable income. Depending on the tax laws in your state of residence, these deductions may also be exempt from state income tax.

As we are concerning ourselves with insurance coverage while still on active duty, how should SBP be valued? While it is impossible to know how long we will live, or whether we will die on or after retiring from active duty, we can make an approximation, utilizing the current pay scales, pay grade and number of years of service. Utilizing the two examples above of an

0-6, and 0-5, we can go back to our calculation made earlier utilizing an assumed rate of return. Remember that the estimated rate of return is divided into 12 to establish the factor to determine how much capital is required to produce a certain amount per month. If we use a level of 8%, the factor of 150 (12 divided by 8) times $1839 (SBP for an 0-6 at 26 years) equals $275,850; or times $966 (SBP for an 0-5 at 20 years) equals $144,900. If we increase the return to 12%, we reduce the coverage requirement to $183,900 and $96,600.

As you recall, the variables of time and return on our money will influence heavily your calculation of how valuable SBP will be to your dependents. When you complete FORM 13 on insurance coverage, use the above type calculations to estimate the amount of insurance protection that SBP will provide to your dependents.

CURRENT CHANGES TO SBP

Congress has continued to change the rules on many programs that affect us. SBP is not without exception. The 1985 Congress eliminated the social security offset rule and implemented in its place a two-tier system of benefits, paying 55 percent of retired pay before age 62 and 35 percent thereafter. Other changes include indexing the cost portion of SBP for spouse coverage whenever basic pay rates are increased; providing automatic maximum spouse participation for a married member unless the spouse consents to less or no coverage; and changing the provisions for former spouse coverage to be the same as for spouses, with comparable costs.

These changes are "grandfathered" for those retirement eligible on or before 1 October, 1985. If you are in this status, your spouse will receive the largest payment computed under both system. If you are not retirement eligible on this date, you will fall under the new system. Based on current projections, the new system (two tier) will provide larger payments after age

62 in approximately 95 percent of the cases.

SOCIAL SECURITY SURVIVORS' BENEFITS

Most of us think of social security in terms of retirement benefits, however part of the overall protection your social security taxes provides is survivors' insurance. If you predecease your spouse, Social Security will provide monthly survivor benefits to your spouse providing he or she is caring for one of your children who is still under the age of 16. In addition, each child under the age of 18 will receive a monthly benefit.

The amount of these benefits depends on the salary used to calculate your contribution to Social Security, your age and the year you died. If you have had maximum FICA deductions your spouse would receive approximately $550 a month plus $550 for each child. There are family limitations where a mother is caring for two or more children. The limitation here would be approximately $1300. Remember that these payments continue only until the youngest child reaches 16.

An additional factor to consider is that the spouse's SBP annuity payments will not be reduced until she reaches 62 unless she is in fact caring for one dependent child under age 16. If there is no dependent child or if there are two or more children, the SBP payment will not be reduced. In other words, the reduction only takes place before the spouse reaches age 62 when there is one dependent child. The reason is that during this time, the spouse is receiving survivor's insurance to help support this child.

Under any circumstance, the spouse becomes eligible to a monthly Social Security survivor benefit as early as age 60 (50 if disabled). Again this amount is based on the spouse's Social Security earnings record and varies with her age at the time she begins receiving the benefit. At age 60, the spouse receives 71.5 percent of her husband's social security benefit, increasing by 5.7% yearly up to 100% at age 65. One could expect this amount

to be in the $550 to $1000 range. Remember at age 62, the SBP offset occurs. In 1985 figures, these offsets range from $477 for an officer who died at age 40; $531 for death at age 45; $566 for death at age 50.

The key point is that even with the Social Security offset, the spouse of an officer who died on active duty or who was awarded SBP would have available to her at age 60 approximately $2,000 or more from a combination of SBP, DIC, and social security. The exact amount will depend upon the age of the service member. at time of death, his rank, number of years on active duty, and number of children under the age of 16.

To learn more about these programs, you should consult with your legal assistance officers. A personal recommendation is to utilize the expertise of the officers of the Army Mutual Aid Association, the Navy Aid Association or the Retired Officers Association. Each of these organizations, located in Washington, D.C., are well prepared to answer questions based on the specifics of your personal situation. These organizations are highly recommend.

SOME RULES TO CONSIDER

Hopefully by now, you are comfortable with the concept that life insurance is designed only to provide financial protection for your family as you build our financial independence. In doing so, here are some very good rules:

rmine your life insurance needs as if you were going to die today. This is very valid as you consider the added protection from government programs such as SGLI, DIC, SBP, and Social Security Survivor's insurance.

2) Life insurance is designed to cost more each year, because you are more apt to die.

3) Every time a new mortality table is issued by the insurance industry, examine the potential cost savings to you.

4) Life insurance is for dying. Investments are for living. Do not mix the two.

5) Life insurance is pure protection (term) or pure protection plus a saving account. Always consider the opportunity cost on the saving portion. Do not use an insurance company for banking.

6) Be sure that your policies are renewable and do not contain any war restriction clauses which eliminate coverage during hostilities.

7) Never buy a "participating" whole life policy. You'll lose every time.

8) Always compare the net payment cost on like policies. Give preference to the least cost if other measures are comparable.

WEALTH BUILDING STRATEGIES

1) Maximize the use of Government insurance programs.

2) Employ knowledgeable military-oriented insurance companies to analyze, explain, and assist in development of a low-cost, high payout insurance protection program.

3) Avoid whole life policies which do not pay market rate levels of interest on the cash value portion.

4) Establish your dependent protection program in the following order:

   a. SGLI- maximum amount of $50,000.

   b. Whole life policies from military-oriented companies such as Army Mutual Aid Association to obtain low-cost protection plus utilize their expertise in handling of government death benefits and beneficiary requirements.

   c. Term insurance from military-oriented insurance companies such as Armed Forces Relief and Benefit, and Navy Mutual Aid Association.

   d. Fill any protection gap through purchase of a flexible (universal) life policy from companies with a A.M. Best co."A+" rating and with high payout on cash portion of policy and minimum cost structure. Watch the amount of early cancellation costs and administrative

expenses which will significantly reduce the interest payout. Rated as one of the best companies is USAA Life Insurance Co. with high tax-deferred cash interest payout and extremely low cost structure. Armed Forces Relief and Benefit has just added an Universal Life policy to their offerings. Be sure to compare these two as a minimum.

4) Value SBP utilizing the formulas presented in this section. Selection of an 8-10 percent interest rate is advisable.

5) Consider the tax strategy discussed in this section whenever you desire to obtain low-cost funds from any form of whole or variable life policy. The concept works exceptionally well for universal life type policies.

SECTION V

PROTECTING YOUR ASSETS

In addition to utilizing life insurance to provide protection for the future well-being of your family in case of your death, it is equally important to your financial well-being to examine the requirement to protect your existing personal and physical assets. The first step in this process is to conduct a risk analysis and risk evaluation. These steps are needed to determine your exposure to risk, determine its cause and the degree of control that you have over it.

Most of us have already made this type of analysis and evaluation when we purchase auto and homeowner's insurance, however there are several other areas which we should examined to complete this program. Additionally, we should go back and insure that our current insurance coverage is providing the quality protection we think it is.

There are four basic ways of dealing with risk to your assets:

1) Risk Avoidance. This is simply the act of eliminating risk by avoiding the causes of risk. If we choose not to drive a car, there is little risk from an auto liability point.

2) Risk Reduction. This consist of all activities intended to prevent the occurrence of a loss. We attempt to reduce the probability or the consequences of the loss occurring. You have a choice of retaining the risk or transferring it to others.

3) Risk Retention. This consist of the conscious act of keeping or assuming a risk rather than transferring it to others. Some risk, like combat, can't be transferred. Others, like small or infrequent losses, are retained because of economic considerations. When we add deductible clauses to our insurance policies, we are retaining a certain level of risk.

4) Risk Transfer. This consist of any measure by which the risk of one party is transferred to another. Insurance is the most important type of transfer device and is defined as the transferring of risk to a third party in return for the payment of an amount of money.

Not all risks are insurable, however there are many potential serious events, such as fire, automobile accidents, robbery, and personal liability which could cause substantial financial loss if they occurred. The principle of insurance eliminates or reduces the financial burden of these losses by dividing them among many individuals with similar protection needs.

In making insurance decisions, individuals have to determine which risks should be insured and which risks can be handled in other ways. As an example, the loss of a home worth $60,000 to an individual with a net worth of $90,000 indicates the relative value of a risk of the home to be 2/3, a risk level to high for the individual to bear alone as 2/3 of his net worth would be lost. This form of large-lost insurance coverage is considered essential. The severity of lost, not frequency should be the determining factor. On the other hand, the use of deductibles for small risk losses not only makes insurance less expensive, but by eliminating small losses, you can purchase much higher benefit levels and guard against the possibility of a major loss.

Once a risk analysis and evaluation has been conducted, a decision can be made on the amount and type of coverage by determining the maximum loss and how much of this loss we want to transfer to others. Let's look at this process for several important risk management areas.

HOMEOWNER'S COVERAGE

The homeowner's policy insures your home against fire, lightning, wind, storm, hail and many other perils. One of the key questions which must be asked is what should be the maximum loss coverage? Unfortunately, many people have not updated their coverage to reflect the actual value of their home. If

your coverage falls below 80 percent of the replacement value of the house, co-insurance rules come into play, which in essence causes you to share the risk with the insurance company. You will be paid for only a portion of any damages, regardless of the coverage. To help preclude this from occurring, you should complete a Dwelling Evaluation form (USAA or Armed Forces Insurance will provide one) and update your coverage as required.

There are basically four variations of Homeowners policies, ranging from simple fire, lightning, and theft coverage HO-1, to the very extensive coverage found in the "All Risks" coverage of HO-5. As is common with package policies, these policies can be altered by endorsements which increase the amount of insurance and/or broaden the coverage, such as basing losses on replacement cost without any deduction for depreciation.

Three other aspects need to be considered: limits on certain kinds of property (jewelry, cash, stamps, gold, silver, etc); liability exclusions (boats, business activities, other premises, rented property, etc); and eligibility (dwelling is owner-occupied). Protection is generally provided through the use of "floaters", meaning that the insurance follows with the property, regardless of where it is located. One will have the choice of coverage under "scheduled" property, which provides "all risk" protection to the items insured, or "unscheduled" property, which insures against major hazards. If you cover your high value property under the "scheduled" floater, ensure that you make a photograph for future "proof" if required.

There are several military-oriented insurance companies who provide full coverage tailored to the military officer. You should start with them in determining who can provide the broadest coverage at the lowest cost. The HO-5 policy should be chosen unless there are cogent reasons to reduce the broadness of coverage.

AUTOMOBILE AND RECREATIONAL VEHICLES

These policies provide coverage for your automobile liability, medical payments, physical damage to the automobile, and related exposures, such as uninsured motorist protection. With the continued high level of court settlements being paid, it is a prudent move to obtain as much coverage as reasonable.

Sufficient bodily injury liability insurance is mandatory. It pays the fees and expenses of an attorney to defend you against these types of lawsuits and pays the settlement if you lose the court case or settle out of court. I've talked with some officers who, in the efforts to hold down cost, take only the state required minimums. They did not realize for $50 or so, they could increase their liability protection to $500,000 per accident.

Collision and comprehensive coverage should be retained only if your car is less than five years old or an expensive foreign car. The insurer will pay you only for the market value if it's stolen or damaged beyond repair. You should also watch the level of your deductibles. Establishing high deductibles with the premium difference (50% reduction between $100 and $500 deductible) going into alternate investments could make you self-insured after several years with no accidents.

If you have a child attending school over 100 miles from home and he or she is carried as a driver on your car at home, ensure that this information is reported to the insurance company. Your premium will receive a nice reduction.

As with a homeowners policy, ensure that you understand the exclusions to your policy, which may or may not affect your insurance company choice.

EXCESS LIABILITY

Every military officer should secure this coverage. You only have to read of the $1,000,000.00 awards to see the danger. While targets for these levels

of damages, the danger also exists that these type of claims would not necessarily be covered by standard policies.

One way to increase your protection is to increase the coverage of your policies. A better way to do this is to add an "umbrella" liability policy which takes affect when you have reached the liability limits of your standard liability policies. The policy is inexpensive- approximately $100-$150 for $1 million worth of additional coverage. The way to structure this is to set your limits on your auto and home at the minimum coverage level acceptable to the insurance company and add the umbrella on top up to the level you desire. Generally, the umbrella policy cost per $1000 is less than the standard policy cost.

While the likelihood of such a major liability loss is quite small, the average officer would be destroyed financially. This is a risk you should not take. USAA has a good policy which ties into their auto and homeowners policies, minimizing total policy cost considerably.

MEDICAL INSURANCE

While the question of quality of military medical care is beyond the limits of this publication, the question of obtaining medical care after retirement or during periods of limited military support is very applicable. You will find that you have to utilize the CHAMPUS program which, by design, will cost you for portions of your medical care. To provide for this eventually, you may desire to obtain a CHAMPUS supplement insurance policy. There are several group health insurance programs available, one of the best is offered by The Retired Officers Association (MEDIPLUS).

WEALTH BUILDING TECHNIQUES

1) Analyze and evaluate your risks. Look for loss-producing hazards.
2) Select those policies and coverages which you need. Use deductibles, and specific coverages where required.
3) Incorporate an Excess liability policy into your coverage.
4) Evaluate and update your program periodically and as your personal, family and economic status changes.
5) Remember "Don't risk more than you can afford to lose. But don't insure what you can afford to risk".

SECTION VI

HOMEOWNER OR TENANT?

How To Make A Wise Choice

Until a few years ago, one of the more fundamental decisions that Americans made was to decide where to live. Today, that decision is being denied to the average American because of the high prices of houses and the cost of mortgage money. These same issues confront each of us in the military. However, not only do we have to address these decisions, we have to look at the effect that our mobility has upon the ability to purchase a house and subsequently sell it without being economically worse-off. The fact that a portion of our military compensation is tax exempt, government quarters are normally available and that a normal tour is 3 years or less has significant economic bearing on this question.

All else being equal, renting or buying would simply be alternative methods of financing one's chosen home. However there are factors, such as the tax laws that have a different impact on homeowners and tenants. These factors are reflected in the market prices of owner-occupied and rental properties and in the amount of housing that an individual can obtain with his housing funds.

Not withstanding the intangibles of home ownership, income taxes are the most important financial aspect for an individual's choice of shelter. This is reflected in two ways: First, certain costs of homeownership are deductible from income in computing income tax payments, whereas renters' outputs are not. Second, the returns associated with residential investments are taxed relatively little, and infrequently, due to the capital gains treatment and the roll-over effect of residence sales and repurchases. A reconfirmation by

Congress that military homeowners can deduct in full their mortgage interest payments without offset of the BAQ and VHA tax free payments adds to the importance of tax consequences. Similarly, the extension to 8 years, in cases of overseas´ tours, of the suspension of the principal residence reinvestment period adds to the benefits of deferred capital gains treatment accorded to homeownership.

While these changes have benefited homeowners, there continues to be proposed changes which negatively affects homeownership. The proposed Tax Reform Bill of 1985 will reduce the tax advantages of homeownership over rental by redesigning and reducing current tax rates, and eliminating or "capping" homeowners´ deductions. With the indexing of the "zero bracket income" (the old standard deduction) combined with proposed increases, the value of housing related deductions will be reduced. Since taxes create advantages, it should not be surprising that tax reductions reduce the advantages.

´STORICAL REVIEW

During the 70´s, the prices of houses shot up greatly due to inflation. During this period of time, the return on homeowners´ equity was vastly superior to that obtained from other forms of investments such as stocks, bonds, saving accounts, etc. Additionally, these increases received special tax deferrals and exemptions not generally available to other investments. Thus far during the 80´s, there have been significant changes in the trends of shelter costs. Rents increased at a compound rate of 6.2 percent during the three year period ending in 1985. The index of homeownership costs, the price paid to become a homeowner, continued to increase markedly through 1982, but has changed little since. Because of this disparity, there is belief, in some economic quarters, that the superior investment return, which justified a tenant paying a substantial premium to become a homeowner has begun to

vanished. The latest figures indicate that the rate of return on homeowner's equity since 1979 is less than returns on assets such as stocks, bonds, and other fixed-dollar investments.

These figures raise questions that should be consider in appraising the outlook for housing appreciation: Will owner-occupied homes continue to serve as a store of value? Will houses appreciate more or less rapidly than other investment opportunities? and will the inflation premium in mortgage interest rates compensate lenders for the depreciation of the dollar?

As long as inflation continues, the equity in one's house (the down payment and principal payments) is likely to provide this value. However, for the short-term, those who buy now will still pay a substantial premium to obtain homeownership. The 1986 home buyer cannot expect to obtain the same degree of investment success found during the 1970's. Given the mortgage interest rates in relation to the rates of the early 70's, the current buyer must have his house appreciate much more rapidly than other prices to come out ahead. Houses outpaced other investments during this previous period, however, today's buyer must watch out not to receive a negative real rate of return where the house value is less than the real payments to own the house. The key will be price increases over the near term, increases which are questionable in some metropolitan areas.

If homeownership fails to provide a superior investment real rate of return, and other than the value of a "forced savings" for some, the true question that must be examined is whether some other use of the down payment and the monthly outlays in excess of renting would provide a better source of capital value. From one perspective, this is why the housing market has been as weak as it has, considering the many opportunities to participate in the tremendous appreciation of the stock and fixed-income markets of the past 4

years. Some low-risk, high total return mutual funds and individual stocks have appreciated 140-170 percent or more during this same time period. There is sufficient evidence to state that houses are likely to retain their store of value (maintain appreciation at rate of inflation), but they are unlikely to continue to provide the real gains that was experienced during the 1970's.

THE RENT OR BUY DECISION

If we left this decision to our wives, there would probably be many more homeowners. While your personal preference regarding housing will be one of the most important aspects in your decision to rent or buy, your ability to follow your personal preference will be greatly influenced by financial considerations.

In summary some of these are:

1). The advantage to you to pay property taxes and mortgage interest with pre-tax dollars. For this to occur, your total itemized deductions for tax purposes must exceed your "zero bracket income" if the deductions are to have any tax-savings to you. For 1986, this amount for married, joint fillers is $3670. Currently, the zero bracket is indexed to the CPI, consequently this level will continue to increase. This requires your annual itemized deductions unrelated to housing to continue to expand for you to end up paying your property taxes and mortgage interest with pre-tax income. If you do not have other deductions equal to the zero bracket, your housing costs will be less valuable to you for tax purposes.

2). Your ability and willingness to perform maintenance and repair work yourself. This aspect represents the homeowner's "sweat equity" which may represent costs which are never recouped, even though some of these costs can be added to the basis of your property. Rental accommodations (or government quarters) are generally easier and cheaper to maintain.

3). The length of your stay in a given residence. Transactions costs,

currently about 10-12 percent on a sale and purchase, will generally outweigh any financial advantages to you from homeownership if you plan to move within two or less years.

4). Your eligibility to receive special government assistance, such as FHA and VA loans. Given the current budgetary difficulties in Washington, watch for announcements that may significantly reduce these benefits.

5). Your desire to acquire or accumulate equity in a house. For many individuals, homeownership acts as a "forced savings" program. As discussed earlier, questions over alternative investments and negative real rates of return need to be examined. With interest rates at a relatively high level and inflation the lowest in many years, the expectation that houses will continue to be other than a basic store of values is currently unsupportable.

In addition to these financial aspects, there are several personal and other non-financial considerations which require discussion. The rights and responsibilities of renders differ in many respects from those of homeowners. As a tenant, your financial obligations end after payment of rent and the cost of utilities. Not only are the number of bills paid by homeowners much larger than that of tenants but their outlays are more irregular and uncertain. Additional, as any wife knows, no home is perfect, therefore the need for redecorating, remodeling, add-ons, new appliances, etc. are always under consideration. Whether you can recover these cost upon resell is problematic.

On the following pages you will find worksheets and instruction guides to help make the buy or rent decision. In reaching your decision, you should consider the basic expenses (rent, mortgage payments, property taxes, maintenance, repairs, and insurance), plus outlays such as the various form of utilities. If a particular residence has specific requirements, these should also be added in and considered.

HOUSE BUYER'S WORKSHEET

ESTIMATED GROSS OUTLAYS DURING FIRST YEAR OF OWNERSHIP

1. Mortgage payments of $______ per month X 12 ________
2. Payments on other borrowings (annually) ________
3. Property taxes ________
4. Maintenance expenses ________
5. Homeowner's insurance ________
6. Utilities (electricity, gas, telephone, etc) ________
7. Gross outlays ________

ESTIMATED TAX SAVING DURING FIRST YEAR OF OWNERSHIP

8. Tax deductions

   Mortgage interest ________

   Other interest ________

   Property taxes(line 3) ________

   Total deductions ________

9 Zero bracket income amount ________

10. Tax deductions other than homeownership deductions ________

11. Line 9 less line 10, but not less than zero. ________

    Usable deductions attributable to homeownership (line 8 minus line 11) ________

12. Tax saving from homeownership. Line 11 multiplied by your marginal tax rate of _____%. ________

ESTIMATED NET COST OF HOUSING DURING FIRST YEAR OF OWNERSHIP

13. Gross outlays less tax saving (line 7 minus line 12) ________

ESTIMATED INITIAL CASH NEEDS OF BUYER

14. Cash demands

Purchase price of house	________	
Closing costs	________	
Renovation and repairs	________	
Moving expenses	________	
Other outlays	________	
Total cash demands		________

15. Cash sources other than buyer

Mortgage borrowing	________	
Other	________	
Total cash from others		________

16. Cash the buyer must supply ________

To help prepare the buyer's worksheet, use the following instructions:

Line 1- Obtain estimate from lender or broker, or from tables at the end of this section.

Line 3- Obtain estimate from lender, broker or current owner.

Line 4- Estimate 1 percent of the purchase price of house.

Line 5- Obtain from insurance company or agent.

Line 6- Obtain from current owner or broker.

Line 8- Obtain interest estimate from broker or tables at end of this section.

Line 9- Zero bracket is $3670 for 1986.

Line 10-Utilize your last tax return, Form 1040, Schedule A.

Line 12-Find your tax rate in your last year's Form 1040 tax information book.

Line 15-Under other, include borrowings, insurance loans, etc.

RENT OR BUY WORKSHEET

ANNUAL COMPARISON OF OWNING OR RENTING

Line 1- Estimated annual outlays associated with owning ________

Line 2- Rent of $______ per month X 12 ________

Line 3- Utilities (Electricity, telephone, gas,etc) ________

Line 4- Household insurance ________

Line 5- Annual outlays as tenant (Line 2 to 4) ________

Line 6- Annual difference (Line 1 minus Line 5) ________

Line 7- Cost of funds invested in house

a. Actual or possible cash ________

b. Percent annual after-tax return on alternative use of cash ________

c. Opportunity cost of homeownership (Line 7a X Line 7b) ________

Line 8- Total annual difference between owning and renting (add Lines 6 and 7c) ________

COMPARISON OF OWNING OR RENTING AFTER A NUMBER OF YEARS

Line 9- Current price of house ________

-Value of $1 increased by ____ % for _____ years. ________

Line 11-Price of house after ___ years(Line 9x10) ________

Line 12-Transactions costs ______% X Line 11 ________

Line 13-Cash proceeds after ___ years (Line 11 minus 12) ________

Line 14-Deductions from cash proceeds:

a.Basis of house ________
b.Taxable gain (Line 13 minus 14a)________
c.Taxes at ___ percent X 14b) ________
d.Amount of mortgage outstanding after ___ years, ________
e.Total deductions from cash proceeds(c+d) ________

Line 15-Possible net cash available if home owner
for ____ years. (Line 13 minus 14e) ________

Line 16-Annual advantage of renting over owning
(from Line 8 if positive #, otherwise stop) ________

Line 17-Value of an annuity of $1 accumulated
at ____ percent for ___ years. ________

Line 18.Accumulated savings if a tenant for
___ years (Line 16 X 17) ________

Line 19.Actual or possible cash invested
in house (Line 7a) ________

Line 20.Possible net cash available if a
tenant for ___ years (Line 18 plus 19) ________

The following will explain the calculations for this worksheet. Many will be estimates which you can adjust to determine their impact.

Line 1- Enter the amount from Line 13 of the home buyer's worksheet.

Line 2- Use your BAQ plus VHA figures unless you expect to make higher rental payments.

Line 3- Enter the amounts you will pay, if any, in addition to your rent payments.

Line 4- Include the cost for personal liability and HHG coverage.

Line 6- If the figure is positive, the annual outlay for owning is larger than for renting; if negative, the outlay for renting is larger than owning.

Line 7- There is a cost associated with having equity in a house. This cost is the opportunity cost of using your equity in for your house instead of in some other investment. Line 7a is the amount of cash that you would tie up in the purchase of the home. Use Line 16 of the house buyer's worksheet. On Line 7b enter your estimate of the after tax percentage return that you would receive on the cash on Line 7a. For the average officer in the grade of O-5 and O-6, your marginal bracket is 30%. If you invested this money in a long-term Treasury note, you could earn approximately 10%, giving you a 6.7%

after-tax return.

Line 8- If the figure on Line 8 is positive, it would represent monies that you would have available for either investing or spending on nonhousing expenditures. If Line 8 is negative, and you feel comfortable with your estimates, you will be better off owning a house. Line 9- Enter the figure from Line 14a of the homebuyer's worksheet.

Line 10-This is the first of several estimates. Enter the average annual increase in the price of the house for the number of years you selected. Find the number for Line 10 from the $1 compound interest table at end of this section. If you assumed, for example, a 6% increase per year for 20 years, the correct figure to enter is 3.21.

Line 12-Transactions costs generally run about 8%. Adjust if appropriate.

Line 14-The basis of the house is the original purchase price plus adjustments for closing cost paid at the time of purchase and cost of home improvements and additions. Enter on Line 14c, 40% of your estimated tax bracket that will apply at the time of sale. While a difficult task, I would use your current tax rate as a conservation figure. For Line 14d, obtain from a broker the appropriate mortgage balance.

I·   Enter the amount from Line 8 above. If negative, there is no utility in completing this section as you should buy.

Line 17-Enter as a percent figure the figure on Line 7b. Use the Amount of Annual Payment of $1 Compounded Annually. For example, 6% for 20 years is 38.99. If Line 7b is not a whole number, either interpolate or round to nearest whole number. Use the table at the end of this section.

The amount shown on Line 20 is the estimated cash you would have available after the number of years you have specified if you were to rent. The comparison of Lines 15 and 20 will reflect, from a financial standpoint, whether you should rent or buy. You should be cautioned that the assumptions

about price trends, rates of return, the number of years of occupancy, etc. will greatly affect your results. You should look upon these calculations as possibilities.

There are two assumptions which cannot be altered simply by changing the numerical values. These are: one, the annual difference in outlays (Line 16) will remain the same in each of the projected years. We make this assumption on the basic that mortgage payments will remain constant while other costs vary according to the general price levels. Two, the calculation is based on the assumption that the difference will be saved and invested.

MORTGAGES

If the above analysis reveals that you should purchase a house from an economic standpoint, the next question deals with how much house can you afford. This question is of great importance today. Mortgage lenders and appraisers stress the housing-income relationship in deciding your ability to afford a particular house. Because of the new variety of mortgages available to house buyers, the old rules of 30-35 percent of current income dedicated to housing expenditures no longer applies. The difficulty is that sales prices, coupled with relative high mortgage rates, have pushed families to the point where either a large down payment or "creative" financing is required to qualify a family for an average house. What has been learned over the last few years is that the ability to pay for housing is a relative matter. What we can afford depends not only on our incomes but on our willingness to spend our income dollars on housing as opposed to other investments or expenditures.

In determining the maximum mortgage for which you can qualify, you should use the annual statement of Regular Military Compensation statement which reflects the total amount of earnings which is credited to you. If you do not have a current copy, ask your finance officer for one.

The home mortgage market is vastly difference from what it was in your parents day or even when you took out your first home mortgage. In addition to the ability to borrow more, the various types of mortgages have increased in scope and complexity.

The four major lenders of residential mortgages are commercial banks, savings and loan associations, mutual savings banks, and life insurance companies. Saving and loan associations hold about 45 percent of the total mortgages. The other three lenders hold about 15 percent each, with the remaining percentage being held by individuals and other types of lenders.

Over the past two years, the dominant type of loan has been the adjustable rate mortgage. There are many varieties of adjustables available, and you are cautioned to ensure that you understand the rules before signing up for one. The key to an ARM is to understand its terms. What index will be used to adjust the mortgage interest rate? What is the maximum amount that the interest rate (rate cap) can increase in any one year? What is the maximum interest rate cap for the life of the loan? Generally the answer is 2% annually, and 5% total. If the initial interest rate is set below the current mortgage rate, what is the loan margin that the bank can charge? Usually it is 2.5% added to the original interest rate. You should remember that an ARM is an attempt by the bank to protect itself from unanticipated inflation. It is, however, an excellent way to purchase a home in that ARM initial rates are 1-2 percent below fixed rate mortgages.

If you are trying to purchase a home with little down, the way to accomplish this is to take out a FHA or VA mortgage. The rate on these loans are generally 1/2 to 1 percentage points less than a conventional mortgage. In addition, you have the right to prepay your loan at any time without penalty, and the right to sell your home on an assumption to anyone, veteran or otherwise. The disadvantages center around the miles of red tape and

delays associated with dealing with the government, and the add-on points that are charged to provide the mortgage lenders an offset to the lower than market interest rates.

Conventional loans are generally faster to close than FHA/VA loans however they may be costlier due to the level of closing costs and down payment required. At the same time, there are few or no points charged on the mortgage.

The answer to the question of financing is to make the calculations such as presented earlier in this section. You must consider not only the interest rate charged, but the points and other closing costs. The biggest difference will be derived from the interest rate charged. On an $80,000 mortgage, the following payments would be required over a thirty year period:

8%	$587
10%	$703
12%	$823
14%	$948

Again you see the impact of time and rate of return on the use of money. Reducing the mortgage period 15-25 years will increase your monthly payments but significantly reduce the total amount of interest paid over the life of the mortgage. To help make this decision, obtain the different payment amounts from your broker. Generally, you will be better off to take out a 30 year mortgage, then make the necessary prepayments to reduce the effective mortgage life to 15 years.

DOWN PAYMENT

While it would be ideal for us to be able to choose the time to shop around for both a house and a low-cost mortgage, the nature of our business does not permit this. Consequently, we must do our homework if we expect to

purchase a home with the lowest up-front costs including interest rates. This raises the question of how much equity should on put into purchasing a home? Assuming that you have enough savings to exceed the required down payment, the answer lies in the opportunity cost of this money. During periods where interest cost are less than what could be earned in relatively safe investments, you probably should maximize the amount of the mortgage. If the opposite occurs, you should reverse this decision. Additionally, current mortgage lender practice is to decrease the interest rate with the amount of down payment. This is understandable as the lenders risk is lessen considerably.

The most overriding trade-off is the tax treatment of mortgage interest, which is fully deductible as an itemized deduction against earned income on your tax returns. Keep in mind that over the first five years of a mortgage, the interest portions of the payments mount to 99.6%, 99.2%, 98.8%, 98.2%, and 97.7%, all fully deductible.

Calculations utilizing the worksheet presented earlier in this section, and taking into consideration one's marginal tax rate and the time value of money, will help you make a comprehensive analysis of this question.

W[illegible] TO DO?

From recent experiences, the major impact on a housing decision is the estimated time that one will remain in a home. In running many sets of figures for fellow officers, on average, one must remain in the same house for at least 2+ years to amortize down the cost of purchasing and then selling the house. With appreciation running at 4-5 percent in the majority of cities, unless one is able to "buy in" low and sell with little expense, the possibility of earning a market rate of return on your investment is very slim during the first two years. This analysis is true for all types of mortgages and interest rates (8.5% to 12%). The best possibilities lie with ARM

mortgages with low initial rates (8.5%), 1-2 percent closing costs and a low (5-10%) down payment. You must do the figures and then shop for the best terms to come out ahead.

FREQUENTLY ASKED QUESTIONS

1. What are the rules on tax treatment of any gain on the sale of my residence? Section 1034 of the IRS Code provides that a taxpayer does not recognize gain from the sale of a personal principal residence under certain conditions. These are:

1. That the taxpayer constructs or purchases a new principal residence

2. Within two years before or after the sale of the old principal residence and

3. The gain from the sale of the old principal residence is recognized only to the extent that the adjusted sales price of the old principal exceeds the cost of the new principal residence.

Section 1034(h) provides special relief to active duty military personnel by extending the replacement time to four years after the date of sale of the old principal residence. Under certain circumstances, Congress has approved a suspension of up to eight years if service members are assigned overseas after 21 July, 1984, and sell their residence after that date. Deferal is also given if, upon return, they are ordered to live in government quarters. The suspension is terminated at the earlier of the end of eight years or when neither of these two special provisions apply.

2. What is the effect on the rollover of capital gains if a principal residence is rented on a temporary basis, then subsequently sold? The IRS has presented many convoluted answers to this question, however the following can be a prescriptive answer based on several tax rulings:

During the period of time that your are actually renting the property, you

may use the normal deductions applicable to rental property, such as depreciation, interest and tax payments, expenses to collect rents, expenses to maintain the residence, and any travel expenses to inspect the property.

The IRS and Courts have applied three basic criteria in determining the applicability of Section 1034 which permits the sale and deferral of capital gains. These criteria follow the merits of the RALPH T. TRISKO vs. COMMISSIONER, 29 T.C. 515 (1957). In this case the service member built a house in 1941 and occupied it as a principal residence until June 1943. After entering the Navy in 1943, Trisko went overseas and rented the residence for almost a year before returning to it. In 1948, Trisko returned overseas, renting the residence below market value to obtain a responsible tenant to maintain and preserve the premises. The lease agreements were of short duration so that the Trisko family could move back in once the overseas tour was terminated. In returning in 1951, Trisko could not reoccupy the house because of state rent controls. He bought another residence and sold the old residence. The court held that the temporary residence would not preclude utilizing Sec. 1034 to defer the capital gains. There have been two other cases, ARTHUR K. BARRY vs. COMMISSIONER, 30 T.C.M. 757 (1971) and ROBERT G. CLAPHAM vs. COMMISSIONER, 63 T.C. 505 (1975) which have expanded somewhat the Trisko case.

The following checklist has been developed which could be used to help clarify this question:

TEMPORARY RENTAL CONCEPT (Trisko Criteria)

1. Did the taxpayer attempt to sell the old residence before the section 1034 transaction period-the four or eight year period discussed earlier?

A. No - Go to question #2
B. Yes- Go to question #4.

2. Is the old residence being rented with the primary purpose being care and

maintenance?

Factors:

- Clause in rental agreement stating purpose of the rental is for care and maintenance of the old residence, not for the production of income.

- No significant profit realized from the rental.

- Term of rental agreement is for short periods or includes provision allowing owners quick reoccupancy.

A. Yes - Go to question #3.

B. No - If the intent to return is adequately shown, the rental will probably not be considered as a trade or business, which would require any gains to be treated as ordinary income.

3. Did the taxpayer intend to return to old principal residence?

Factors:

- Statement in rental agreement of intent of owners to return to the old residence.

- Assignment is temporary.

- Service Member bought another house.

- History of buying and selling houses.

- Military facilities in area for exercise of retirement privileges.

- Relatives living in the area.

- Rejection of unsolicited offers to buy the residence.

A. Yes - If the answers to question #1 and #2 are also Yes, then the taxpayer can probably use section 1034 under the temporary rental concept.

B. No - Probably unable to use section 1034. Gain on the sale of the old residence will be recognized.

PREVAILING ADVERSE ECONOMIC CONDITIONS CONCEPT (Clapham case)

4. Was the selling price the taxpayer wanted "reasonable"?

Factors:

- Amounts of rejected offers
- Real estate appraisals
- Recent selling prices of comparable houses in the area
- Actual amount received from sale

A. - Yes. Go to question #5

B. - No. This theory will not apply.

5. Was there a prevailing adverse economic condition in the area which prevented the taxpayer from selling for the "reasonable" price ?

Factors:

- Statistical economic data of the area
- Inflation rate
- House sales rate
- Cost of living increases
- Unemployment rate

A. - Yes. Go to question #6.

B. - No. Then why was the taxpayer not able to sell the old residence at the "reasonable" price? If this cannot be answered adequately on an economic basis, then this theory will not apply.

6. Was the renting of the old residence ancillary to the selling efforts?

Factors:

- Short rental periods
- Rental agreements contain options to buy
- If rental agreements contain no option to buy, then must keep trying to sell during rental period, and statement of care and maintenance as purpose of rental.

A. - Yes. May be able to use section 1034 based on the prevailing adverse economic conditions concept.

B. - No. This theory will not apply.

The above legal review was taken from DA Pam 27-50-130 which your legal assistance officer should refer if you have questions in this area. Obviously, the best means to secure an official answer is to request a Letter Ruling from the IRS which could again be handled by your legal assistance officer or a qualified tax attorney.

3. Should I rent my current resident? The answer to this is a qualified yes, especially if you purchased a modern, well constructed home in a good neighborhood and you anticipate to return to the area. Given these conditions, the potential tax advantages which accrue to you are many. Primarily, you can deduct all of the expenses originally taken as a homeowner, plus depreciation, management fees, maintenance costs, and expenses of determining and paying taxes. These expenses are actually more valuable to you as a rental than as a home owner because they are fully deductible against ordinary income on Schedule E, Form 1040, and do not require the zero bracket offset for deductions on Schedule A, Form 1040.

In making this decision, the use of a worksheet such as used earlier in making the purchase or rent decision will help. In essence we are interested in comparing our return on investment (our equity) to returns on other investments. We do this by reducing our rental income by our cash outlays, adding back the after-tax value of depreciation (depreciation X marginal tax bracket). Divide this result by the amount of equity you have in the property.

For you to come out ahead, your rental property should yield more than passive investments like stocks, bonds, mutual funds. Don't bet on

appreciation. You should look at the ability of the property to generate a satisfactory yield in comparison to other investments.

4. Should I make accelerated mortgage payments? To answer this you must understand how mortgage payments work. Interest is calculated on the declining unpaid principal balance each month. In the first five years of a mortgage, over 98 percent of your payment goes toward interest. On a twenty or thirty year mortgage, the total interest paid during this period far surpasses the original amount borrowed. The following reflects this point.

Amount Financed	Annual Rate	Finance cost for 20 years	Finance cost for 30 years
$50,000	11.5%	$77,973	$128,254
$50,000	12.5%	$86,339	$142,107
$50,000	13.0%	$108,707	$178,940

That's a lot of money! Don't feel sorry for the banks, check your own wallet. The important point is that even though interest payments are fully deductible, no one today pays over 50 percent on ordinary income taxes. With the majority of us in the 25-40 percent bracket, you see that we forfeit the use of a lot of monies which we could use either to increase our investments or to satisfy a consumption need. What are the best ways?

First, talk to your lender about making level prepayments. By adding approximately 14 percent to your monthly payment, you reduce the amount of total payment in half, in essence, cutting a 20 year mortgage to 10 years, and a 30 year to 15 years. Second, you can refinance your old mortgage with 15 year fixed-rate mortgages. Again, the extra payment is only approximately 15 percent more.

The question is - should you do it? The answers to these questions will help you make this decision:

- At what rate can I invest the amounts you would prepay? Does this return

exceed the mortgage interest rate? If so, the extra compounded higher yield would make enough in 15 years to pay off the mortgage.

- What is your current tax bracket? The lower, the less meaningful are interest deduction, so you would benefit by making quicker payments.

- What is the age of the mortgage? The younger a mortgage, the more you will save later on. The older, the dollar savings decline.

- How long do you plan to keep the home? The longer you stay, the larger the savings. Not only will you be able to reduce the mortgage quicker, the buildup in equity occurs sooner. If you do not plan on keeping the house for at least 5-7 years, do not use this technique unless the mortgage interest rate is over 14-15%. If this is true, you are a candidate for the next question on refinancing.

- Financial liquidity must be considered to ensure that there is enough cash on hand to carry out this program.

5. Should I refinance? If your current mortgage rate is two or more points higher than you see advertised, it may pay you to refinance. Before you jump however, there are a few points to consider regardless of the difference in the two interest rates.

As a general rule, refinancing does makes sense if there is a spread of at least three percentage points between the rate on your present mortgage and currently available loans. In some cases, you can save money with as little as a two percent spread. The secret is looking at the refinancing costs versus the reduction in monthly mortgage payments.

Another major factor is how long you plan to either stay in your house or maintain it as a rental property. For refinancing to make financial sense, you must retain ownership long enough to realize sufficient savings in your mortgage payments to offset the renegotiation costs, which are substantial.

The biggest refinancing cost is the bank's origination fees- "points". This fee typically runs 2-3 percent of the borrowed amount, but is tax deductible if you pay it out of your own funds. In some cases individuals have been able to obtain a 1% fee only on the new money. The key is to ask.

If you can refinance your mortgage with the same financial institution, your costs could be relatively modest, especially if the bank still holds the mortgage in its portfolio. If it has been sold, you will probably have to take out a new mortgage which will entail closing costs for items such as recording tax, title insurance, and legal fees. For these reasons, you should start the inquiry at the institution that financed your present mortgage. Don't stop there because each institution is different and will have different rates and types of mortgages to offer you. Let me assure you- as a military officer in the top 10 percent of all US wage earners -(REMEMBER!)- they will want your business.

In visiting financial institutions, you need to inquire on the need to another title search, another credit check, who will pay for the legal assistance, does the property need to be reappraised, a new survey, a new municipal inspection (if required by city code), will the institution charge you an application fee to refinance, how will the tax escrow account be handled. These question apply to both your current mortgage holder as well as any new ones.

Once you have this type of information, work yourself through the following chart. You can use the mortgage tables at the end of this section to determine your new mortgage payment and interest costs. You may want to do some "what ifs" by adjusting the mortgage rates and closing costs. Sometimes the lending institutions will have the flexibility to adjust to your needs. They will if you present your case correctly.

STEP 1 DETERMINING MONTHLY SAVINGS

Present monthly payment	$________
- New Monthly payment	- $________
Savings	$________

STEP 2 DETERMINING CLOSING COSTS

Points	$________
Title search and insurance	________
Credit check	________
Attorney's fees	________
Appraisal costs	________
Survey	________
Application fee	________
Bank recording fee	________
Mortgage recording fee	________
Municipal inspection fee	________
Others (include loan orientation fee if separate from points above)	________
Total	$________

STEP 3 DOES REFINANCING PAY?

$$\frac{\text{Total Closing Costs}}{\text{Monthly Savings}} = \text{Number of months you must live in house to recoup expenses.}$$

You will want to make this comparison utilizing the loan data obtained from a number of mortgage lenders. The lender with the best terms as determined above should receive your primary attention.

You should be aware that all of this effort is without traps. Watch out for the following ones that could cost you extra tax dollars and /or lose you a tax deduction:

- Prepayment of mortgage at a discount. If you hold an old mortgage and the lender offers to allow you to prepay the mortgage and to make the deal attractive, they offer you a discount on the principal, watch out for the IRS. They have ruled that this discount is a discharge of indebtedness to the homeowner, and therefore, produces taxable income.

- Pointers on "points". With almost every loan, the lender will charge a

loan origination fee or "points". These may range for 1 to 5 percent (a point is equal to 1% of the mortgage) and can be deducted from taxable income if 1) they are paid out of your own funds, 2) the charging of points is an established practice in your area, and 3) they do not exceed the number of points generally charged in the area.

Points paid by sellers of a home in order to obtain a mortgage are not interest. They are selling expenses, reducing the amount realized on the sale. Points paid by a buyer of a home to obtain a mortgage can be deducted in full if the above requirements are met. If you pay points on a new mortgage for rental property, the points are amortized over the life of the loan and not deducted in the year of closing the loan. Also be careful when dealing with a VA mortgage, as points are generally paid by the seller which makes them nondeductable.

WHERE TO OBTAIN INFORMATION

The question of buying or renting is one which will require your time and good judgment to properly decide. There is a lot of current information which will help you learn about this complex issue. Some suggestions:

"The Mortgage Money Guide" Federal Trade Commission, Pennsylvania Ave. NW, Washington, D.C. 20580.

SHELTERNET, First Boston Corp., Park Ave. Plaza, New York, N.Y. 10055, a listing of available mortgages from throughout the US. Also an analysis of how much you can afford and if you qualify for a specific loan.

"Consumer Guide to Adjustable Rate Mortgages", Fannie Mae's ARM Guide, P.O. Box 23867, Baltimore, MD 21203.

In resolving the question of buy or rent, please keep in mind the mobility that we in our profession encounter. While it appears that we are giving up a lot of money if we utilize government quarters (and we do), or if we rent without anything to show for it when we leave, unless you do an analysis of

the type found in this section, you expose yourself and your family to the risk of making the wrong decision.

Be conscious of your tax bracket. Every cent on a dollar above it which you pay to the mortgage company is of no economic value to you. Similarly, if you convert your house to rental property, a negative cash flow is seriously eroding your investment base unless the appreciation on the property offsets this loss. Employ your monies to make money. That's the secret to financial success.

WEALTH BUILDING STRATEGY

1) Conduct a economic analysis to help make your decision to buy or rent.

2) Seek out the best mortgage terms from a variety of lenders. Consider Adjustable Rate mortgages as alternatives to fixed-rate mortgages.

3) Conduct an analysis to determine if it pays to make accelerated payments on your existing mortgage.

4) Incorporate tax changes into your analysis, especially the indexing of the zero bracket income which makes it more difficult to fully utilize the tax benefits of your interest payments.

5) Evaluate the issue of mortgage refinancing with qualified tax and real estate advisors. Ensure that the full range of possible closing costs and their tax implications are incorporated into your analysis.

6) Obtain the best available information before you decide on a particular loan package or lender. There are numerous ways to obtain quality lending support at below market rates. Check around before you sign.

7) Don't make your housing decision strictly on a financial basis. Your happiness transcends money!

This breakout of mortgage figures can be used to estimate the cost of mortgages per month and year, the amount of interest paid in selected years, and the principal amount remaining at the end of selected years.

Source: National Association of Realtors

SELECTED CHARACTERISTICS OF MORTGAGE LOANS OF $1,000 AT VARIOUS RATES AND FOR VARIOUS LIVES

Note: All amounts shown in the tables should be multiplied by the *original* amount of your mortgage in thousands of dollars. For example, the annual payment shown for an 8.5 percent mortgage of 25 years is $96.63, and that amount multiplied by 37.5, or $3,62[illegible] would be the annual payment for an original mortgage of $37,500.

INTEREST RATE 8.5%		LIFE OF MORTGAGE 20 YEARS	25 YEARS	30 YEARS
MONTHLY PAYMENT = $		8.68	8.05	7.69
ANNUAL PAYMENTS = $		104.14	96.63	92.27
TOTAL PAYMENTS = $		2082.78	2415.68	2768.09
INTEREST PAID IN YEAR #	1	84.24	84.54	84.71
	5	76.21	79.66	81.66
	10	61.48	70.71	76.07
	15	38.99	57.05	67.52
	20	4.64	36.18	54.46
	25	-	4.31	34.55
	30	-	-	4.11
STILL OWED AT END OF YEAR #	1	980.10	987.91	992.44
	5	881.27	927.87	954.90
	10	699.94	817.71	886.03
	15	422.99	649.45	780.83
	20	-	392.48	620.16
	25	-	-	374.78

INTEREST RATE 9.5%		LIFE OF MORTGAGE 20 YEARS	25 YEARS	30 YEARS
MONTHLY PAYMENT = $		9.32	8.74	8.41
ANNUAL PAYMENTS = $		111.86	104.84	100.90
TOTAL PAYMENTS = $		2237.11	26[illegible]1.09	3027.08
INTEREST PAID IN YEAR #	1	94.25	94.56	94.74
	5	86.14	89.83	91.90
	10	70.59	80.74	86.45
	15	45.62	66.16	77.71
	20	5.55	42.76	63.66
	25	-	5.20	41.15
	30	-	-	5.01
STILL OWED AT END OF YEAR #	1	982.39	989.72	993.63
	5	892.65	937.31	962.41
	10	720.36	836.69	902.08
	15	443.83	675.20	805.24
	20	-	416.01	649.62
	25	-	-	400.37

INTEREST RATE 9.0%		LIFE OF MORTGAGE 20 YEARS	25 YEARS	30 YEARS
MONTHLY PAYMENT = $		9.00	8.39	8.05
ANNUAL PAYMENTS = $		107.97	100.70	96.55
TOTAL PAYMENTS = $		2159.34	2517.59	2896.64
INTEREST PAID IN YEAR #	1	89.24	89.55	89.72
	5	81.16	84.73	86.78
	10	66.00	75.70	81.24
	15	42.26	61.56	72.58
	20	5.08	39.41	59.02
	25	-	4.74	37.79
	30	-	-	4.55
STILL OWED AT END OF YEAR #	1	981.27	988.84	993.17
	5	887.07	932.72	958.80
	10	710.26	827.39	894.30
	15	433.43	662.48	793.30
	20	-	404.27	635.18
	25	-	-	387.61

INTEREST RATE 10.0%		LIFE OF MORTGAGE 20 YEARS	25 YEARS	30 YEARS
MONTHLY PAYMENT = $		9.65	9.09	8.78
ANNUAL PAYMENTS = $		115.80	109.04	105.31
TOTAL PAYMENTS = $		2316.05	2726.10	3159.26
INTEREST PAID IN YEAR #	1	99.26	99.57	99.75
	5	91.16	94.94	97.03
	10	75.25	85.84	91.69
	15	49.09	70.86	82.90
	20	6.04	46.22	68.43
	25	-	5.68	44.64
	30	-	-	5.49
STILL OWED AT END OF YEAR #	1	983.45	990.53	994.44
	5	898.02	941.64	965.74
	10	730.24	845.61	909.36
	15	454.19	687.62	816.55
	20	-	427.68	664.07
	25	-	-	413.03

INTEREST RATE 10.5%		LIFE OF MORTGAGE 20 YEARS	25 YEARS	30 YEARS
MONTHLY PAYMENT - $		9.98	9.44	9.15
ANNUAL PAYMENTS - $		119.81	113.30	109.77
TOTAL PAYMENTS - $		2396.11	2832.55	3293.06
INTEREST PAID IN YEAR #	1	104.27	104.59	104.76
	5	96.20	100.06	102.17
	10	79.99	90.98	96.94
	15	52.65	75.65	88.14
	20	6.54	49.79	73.29
	25	-	6.19	48.24
	30	-	-	6.00
STILL OWED AT END OF YEAR #	1	984.46	991.29	994.99
	5	903.19	945.71	968.82
	10	739.90	854.15	916.22
	15	464.49	699.73	827.52
	20	-	439.28	677.91
	25	-	-	425.58

INTEREST RATE 11.0%		LIFE OF MORTGAGE 20 YEARS	25 YEARS	30 YEARS
MONTHLY PAYMENT - $		10.32	9.80	9.52
ANNUAL PAYMENTS - $		123.86	117.61	114.28
TOTAL PAYMENTS - $		2477.25	2940.34	3428.36
INTEREST PAID IN YEAR #	1	109.28	109.60	109.78
	5	101.26	105.20	107.30
	10	84.79	96.16	102.22
	15	56.31	80.51	93.43
	20	7.07	53.47	78.23
	25	-	6.72	51.96
	30	-	-	6.53
STILL OWED AT END OF YEAR #	1	985.42	991.99	995.50
	5	908.14	949.55	971.65
	10	749.32	862.32	922.63
	15	474.73	711.52	837.87
	20	-	450.78	691.34
	25	-	-	438.00

INTEREST RATE 11.5%		LIFE OF MORTGAGE 20 YEARS	25 YEARS	30 YEARS
MONTHLY PAYMENT - $		10.66	10.16	9.90
ANNUAL PAYMENTS - $		127.97	121.98	118.83
TOTAL PAYMENTS - $		2559.43	3049.41	3565.05
INTEREST PAID IN YEAR #	1	114.29	114.62	114.79
	5	106.35	110.35	112.44
	10	89.66	101.37	107.51
	15	60.07	85.46	98.76
	20	7.63	57.25	83.26
	25	-	7.27	55.78
	30	-	-	7.08
STILL OWED AT END OF YEAR #	1	986.32	992.64	995.96
	5	912.89	953.15	974.25
	10	758.51	870.12	928.60
	15	484.90	722.97	847.71
	20	-	462.19	704.36
	25	-	-	450.28

INTEREST RATE 12.0%		LIFE OF MORTGAGE 20 YEARS	25 YEARS	30 YEARS
MONTHLY PAYMENT - $		11.01	10.53	10.29
ANNUAL PAYMENTS - $		132.13	126.39	123.43
TOTAL PAYMENTS - $		2642.61	3159.67	3703.01
INTEREST PAID IN YEAR #	1	119.31	119.64	119.80
	5	111.46	115.50	117.56
	10	94.58	106.62	112.61
	15	63.91	90.47	104.12
	20	8.20	61.14	88.36
	25	-	7.85	59.71
	30	-	-	7.66
STILL OWED AT END OF YEAR #	1	987.18	993.25	996.37
	5	917.44	956.53	976.63
	10	767.46	877.56	934.18
	15	494.99	734.10	857.06
	20	-	473.48	716.95
	25	-	-	462.41

INTEREST RATE 12.5%		LIFE OF MORTGAGE 20 YEARS	25 YEARS	30 YEARS
MONTHLY PAYMENT - $		11.36	10.90	10.67
ANNUAL PAYMENTS - $		136.34	130.84	128.07
TOTAL PAYMENTS - $		2726.74	3271.06	3842.13
INTEREST PAID IN YEAR #	1	124.33	124.65	124.82
	5	116.59	120.66	122.72
	10	99.56	111.89	118.11
	15	67.85	95.55	109.52
	20	8.80	65.12	93.52
	25	-	8.44	63.74
	30	-	-	8.27
STILL OWED AT END OF YEAR #	1	987.99	993.61	996.75
	5	921.80	959.70	978.62
	10	776.18	884.65	939.37
	15	505.00	744.90	865.91
	20	-	484.65	729.12
	25	-	-	474.38

INTEREST RATE 13.0%		LIFE OF MORTGAGE 20 YEARS	25 YEARS	30 YEARS
MONTHLY PAYMENT - $		11.72	11.28	11.06
ANNUAL PAYMENTS - $		140.59	135.34	132.74
TOTAL PAYMENTS - $		2811.78	3383.51	3982.32
INTEREST PAID IN YEAR #	1	129.35	129.67	129.83
	5	121.73	125.83	127.88
	10	104.59	117.19	123.42
	15	71.87	100.69	114.94
	20	9.42	69.19	98.75
	25	-	9.07	67.66
	30	-	-	8.69
STILL OWED AT END OF YEAR #	1	988.76	994.33	997.09
	5	925.97	962.67	980.82
	10	784.66	891.40	944.27
	15	514.91	755.36	874.30
	20	-	495.68	740.67
	25	-	-	486.18

Line 10 **ONE DOLLAR PRINCIPAL COMPOUNDED ANNUALLY**

End of Year	2½%	3%	5%	6%	8%	10%	12%	15%
1	$ 1.0250	$ 1.0300	$ 1.0500	$ 1.0600	$ 1.0800	$ 1.1000	$ 1.1200	$ 1.1500
2	1.0506	1.0609	1.1025	1.1236	1.1664	1.2100	1.2544	1.3225
3	1.0769	1.0927	1.1576	1.1910	1.2597	1.3310	1.4049	1.5209
4	1.1038	1.1255	1.2155	1.2625	1.3605	1.4641	1.5735	1.7490
5	1.1314	1.1593	1.2763	1.3382	1.4693	1.6105	1.7623	2.0114
6	1.1597	1.1941	1.3401	1.4185	1.5869	1.7716	1.9738	2.3131
7	1.1887	1.2299	1.4071	1.5036	1.7138	1.9487	2.2107	2.6600
8	1.2184	1.2668	1.4775	1.5938	1.8509	2.1436	2.4760	3.0590
9	1.2489	1.3048	1.5513	1.6895	1.9990	2.3579	2.7731	3.5179
10	1.2801	1.3439	1.6289	1.7908	2.1589	2.5937	3.1058	4.0456
11	1.3121	1.3842	1.7103	1.8983	2.3316	2.8531	3.4785	4.6524
12	1.3449	1.4258	1.7959	2.0122	2.5182	3.1384	3.8960	5.3503
13	1.3785	1.4685	1.8856	2.1329	2.7196	3.4523	4.3635	6.1528
14	1.4130	1.5126	1.9799	2.2609	2.9372	3.7975	4.8871	7.0757
15	1.4483	1.5580	2.0789	2.3966	3.1722	4.1772	5.4736	8.1371
16	1.4845	1.6047	2.1829	2.5404	3.4259	4.5950	6.1304	9.3576
17	1.5216	1.6528	2.2920	2.6928	3.7000	5.0545	6.8660	10.7613
18	1.5597	1.7024	2.4066	2.8543	3.9960	5.5599	7.6900	12.3755
19	1.5987	1.7535	2.5270	3.0256	4.3157	6.1159	8.6128	14.2318
20	1.6386	1.8061	2.6533	3.2071	4.6610	6.7275	9.6463	16.3665
21	1.6796	1.8603	2.7860	3.3996	5.0338	7.4002	10.8038	18.8215
22	1.7216	1.9161	2.9253	3.6035	5.4365	8.1403	12.1003	21.6447
23	1.7646	1.9736	3.0715	3.8197	5.8715	8.9543	13.5523	24.8915
24	1.8087	2.0328	3.2251	4.0489	6.3412	9.8497	15.1786	28.6252
25	1.8539	2.0938	3.3864	4.2919	6.8485	10.8347	17.0001	32.9190

Line 17 **ONE DOLLAR PER ANNUM COMPOUNDED ANNUALLY**

End of Year	3%	5%	6%	8%	10%	12%	15%
1	$ 1.0300	$ 1.0500	$ 1.0600	$ 1.0800	$ 1.1000	$ 1.1200	$ 1.1500
2	2.0909	2.1525	2.1836	2.2464	2.3100	2.3744	2.4725
3	3.1836	3.3101	3.3746	3.5061	3.6410	3.7793	3.9934
4	4.3091	4.5256	4.6371	4.8666	5.1051	5.3528	5.7424
5	5.4684	5.8019	5.9753	6.3359	6.7156	7.1152	7.7537
6	6.6625	7.1420	7.3938	7.9228	8.4872	9.0890	10.0668
7	7.8923	8.5491	8.8975	9.6366	10.4359	11.2297	12.7268
8	9.1591	10.0266	10.4913	11.4876	12.5795	13.7757	15.7858
9	10.4639	11.5779	12.1808	13.4866	14.3974	16.5487	19.3037
10	11.8078	13.2068	13.9716	15.6455	17.5312	19.6546	23.3493
11	13.1920	14.9171	15.8699	17.9771	20.3843	23.1331	28.0017
12	14.6178	16.7130	17.8821	20.4953	23.5227	27.0291	33.3519
13	16.0863	18.5986	20.0151	23.2149	26.9750	31.3926	39.5047
14	17.5989	20.5786	22.2760	26.1521	30.7725	36.2797	46.5804
15	19.1569	22.6575	24.6725	29.3243	34.9497	41.7533	54.7175
16	20.7616	24.8404	27.2129	32.7502	39.5447	47.8837	64.0751
17	22.4144	27.1324	29.9057	36.4502	44.5992	54.7497	74.8364
18	24.1169	29.5390	32.7600	40.4463	50.1591	62.4397	87.2118
19	25.8704	32.0660	35.7856	44.7620	56.2750	71.0524	101.4436
20	27.6765	34.7193	38.9927	49.4229	63.0025	80.6987	117.8101
21	29.5368	37.5052	42.3923	54.4568	70.4027	91.5026	136.6316
22	31.4529	40.4305	45.9958	59.8933	78.5430	103.6029	158.2764
23	33.4265	43.5020	49.8156	65.7648	87.4973	117.1552	183.1678
24	35.4593	46.7271	53.8645	72.1059	97.3471	132.3339	211.7930
25	37.5530	50.1135	58.1564	78.9544	108.1818	149.3339	244.7120

SECTION VII

INVESTING FOR FINANCIAL INDEPENDENCE

It is probably safe to say that few, if any, of us entered the Armed Forces for purposes of becoming wealthy. It is equally safe to state that few have become wealthy from serving as a military officer. We have, however, been provided a pay and allowance package which permits us to maintain a very reasonable standard of living.

It is true that a few officers have done better than others. With everything being equal, the reasons can be identified as a knowledge of investments and a commitment to becoming better off financially. Others reasons probably exist: a house in California during the 70's, betting on either the gold or stock market, a working spouse, or having a rich uncle "will" you his estate obviously helped. Most of us however, have spent a great deal of time making money, but little time enhancing our wealth.

As was stated at the beginning of this publication, you need knowledge to help you gain financial independence. Our collective objective is to build a financial knowledge base which will not only increases your wealth while on active duty but which sustains you and your family during retirement. To make this happen will take a commitment NOW, when you have the cash flows and required timeframe to put your plan into action.

At this point on the road toward financial success, we have covered the requirements for building a financial foundation through the creation of a short-term cash and emergency fund, and providing risk protection over our personal lives and assets. We are now ready to deal with the primary means of creating wealth: investing for maximum after-tax returns on our monies, consistent with our objectives and investment/risk constraints. We will employ an investment strategy that will create a careful match between

financial objectives and the types of investments most likely to meet these objectives.

CAPITAL AND INCOME ACCUMULATION

There are many reasons why people want to accumulate capital and income: to create an emergency fund; for family purposes such as to educate their children, purchase a house, car, or boat; to create a general investment fund to maintain or increase their standard of living and financial security; and for retirement purposes.

There are many factors which one has to consider in satisfying these reasons or goals. We can, however, consolidate them into: how much capital will be needed to satisfy the goal; how much is available to invest; the amount of time to reach the goal; and what is the required level of earnings (yield).

As you recall, earlier in this publication we developed a simple formula for obtaining financial independence: **MONEY X RATE OF RETURN X TIME.** This formula is really a restatement of these basic factors. To help put it into perspective, you only have to revisit the financial tables found in the annex. One again, we can clearly demonstrate the effects of time, compound rates of return, and money on the ability to reach our financial goals. Please review and ensure that you understand the relationships between these variables before you proceed.

INVESTMENT CHARACTERISTICS

There are a number of investment characteristics and objectives which deserve consideration as you begin to match your needs and objectives to a specific investment. The most important ones are reflected in the table on the next page. Some will be more important to you than others, given your needs and amount of time and funds available to meet these objectives.

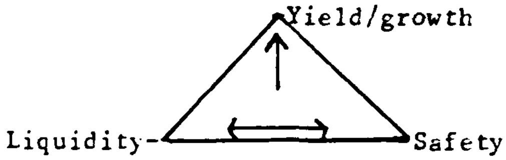
Type of Investment	Safety of Principal in Constant Dollars	Hedge Against Inflation	Current Income	Future Appreciation	Liquidity	Ease of Management
Regular savings accounts	Excellent	Not very good	Fixed; very steady but low rate	None	Excellent	Very easy
Money market investments (Treasury bills, money certificates, money market funds)	Good to excellent	Not very good	Fixed; very steady; rate near inflation rate	Generally none	Very good	Easy
Common stocks						
Income stocks	Fair	Fair	Relatively fixed; rate near inflation rate	Some	Good	Easy
Growth stocks	Moderate to poor	Generally good	Variable; low rate	Moderate to great	Good	Difficult
Bonds (high-quality corporate and government issues)	Good to excellent	Not very good	Fixed; very steady; rate near inflation rate	Generally none except discounted bonds	Good	Fairly easy
Mutual funds (common stocks)	Fair to poor	Variable but generally good	Variable	Moderate to great	Good	Easy
Real estate (income producing, other than residence)	Generally good	Generally good	Variable	Moderate to great	Relatively poor	Moderate to difficult
Precious metals (gold, silver)	Fair to poor	Generally good	None	Moderate to great	Good	Difficult

Source: College of Financial Planning
(non-proprietary)

As you study the table, you quickly recognize that there isn't any one investment that is superior to all others in every characteristic. The reason for this is that the primal investment elements of:

SAFETY of principal
LIQUIDITY of investment
YIELD or growth of investment,

the SLY elements of the financial triangle, have offsetting relationships. To obtain a high rate of return necessitates a reduction in the safety and liquidity elements. Similarly, low yielding investments offer safety and liquidity, but you lose the opportunity to obtain above-average returns. Note the relationships:



We have already utilized this principle when we identified the investments to fund the short-term cash and emergency fund. To gain the desired elements of safety and liquidity needed to meet those investment objectives, we gave up the opportunity for high yields and its' companion, increased risk. The point is that investments should "fit" our specific needs and goals. To fund our short-term needs, other investment factors such as leverage, inflation protection and tax aspects were not of importance. As we increase our investment timeframe and risk levels, these three new elements will begin to influence our investment decision.

INVESTMENT RISKS

Risk and rate of return work in tandem. Risk can be defined as the probability of loss in the future; loss of your invested capital (principal) in monetary terms, or loss through a decline in purchasing power. In both cases, the greater the risks, greater should be the chance of obtaining higher than average returns. This principle is applicable to every investment option

regardless of its nature, structure, cost, or maturity.

When discussing the principle of risk and return (reward), there are four types of investment risk. These are financial risk, market risk, interest rate (money) risk, and inflation (purchasing power) risk.

Financial risk, also called business risk, is the possibility that unfavorable business conditions, or internal financial difficulties could reduce the expected returns from an investment. If sales of a product are significantly reduced due to competition, the ability to turn a profit and declare dividends would be reduced.

Market risk deals with adverse price fluctuations caused by changes in "market psychology" or investors' attitude. The effects could be felt throughout the entire securities market, for a particular industrial group, or for an individual company and its' stock. Shocks, or sudden changes in highly visible indicators of stability such as oil and gold prices, GNP, inflation and interest rates will create this risk. Remember- Problems always create opportunities for someone.

Interest or money rate risk is usually associated with price changes of existing fixed-return investments such as bonds. This is reflected by a decline in the market value of your investment due to changes in the interest rate. In general, a rise in market interest rates will cause a decline in market prices for existing securities, and, conversely, a decline in interest rates will cause an increase in market prices for existing securities. The rule to remember is that market prices on fixed-income securities, such as bonds, will move inversely with changes in interest rates. How much change in value is dependent upon maturity length of the security, its' degree of financial risk and liquidity. High-grade securities such as common and preferred stocks of banks and utility companies are particularly affected by these changes as are real estate values.

Inflation or purchasing power risk reflects the impact that high inflation has upon the purchase power of your money. If you purchase a long term bond or savings certificate and inflation increases significantly, the principal and interest that are returned to you will have less purchasing power than the dollars you invested.

In recent periods of high inflation, fixed-return investments in savings accounts, saving certificates, insurance policies, and bonds have created a substantial loss of purchasing power for those who invested in them. Only in the last three years has this trend been reversed. Bonds, especially tax-free offerings, have produced remarkable returns of approximately 20-30 percent as both interest rates and inflation have declined.

During periods of inflation, investments with a growth potential will usually do well. Real estate, growth stocks and mutual funds generally will provide better protection during these periods.

No one kind of investment provides protection against all classes of risk. Generally if "good" in one area, it is poor or average in one or more classes. As we will see later, the way to overcome this problem is through diversification of your investments. Let's now look at the effects of risk on selected investments:

RISK EFFECTS

Investment	Financial	Market Rate	Interest Rate	Inflation
Savings Acct.	Low	Very Low	Low	High
Bonds (Quality)	Low	Moderate	High	High
Bonds (Junk)	High	High	High	High
Common Stock	Low	High	Moderate	Low
Mutual Funds	Low	Mod/High	Moderate	Low
Houses	Very Low	Low	Moderate	Low

taxable income increases, and therefore his tax bracket, the more attractive and valuable are tax-exempt investments. Currently, if you are in the 22 percent or higher bracket ($21,800 of taxable income for a joint filer for 1986), tax-frees have a place in your portfolio. Consequently, officers in the grade of O-4 and higher should consider these vehicles.

HISTORICAL RATES OF TOTAL RETURN

While the past does not accurately forecast the future, some value can be obtained from a relook at the past. Based upon comparisons through December, 1985, the following total annual returns for 1985 were:

Bonds	42.9%
Stocks	28.7%
U.S. coins	11.5%
Treasury bills	9.5%
Consumer Price Index	3.7%
Housing	2.5%
Gold	(20.3%)

For the past five years, a much better indicator, stocks took first place with annual rates of return of 15.2%, followed by bonds at 13.2%, Treasury bills at 12.0%, Consumer Price Index at 5.7%, housing at 4.3%, and gold and silver last at (11.0%) and (15.9%) in order. The intangible assets (stocks, bonds, and mutual funds) far outpaced the hard assets during this timeframe.

INVESTMENT OBJECTIVES AND RESULTS

In spite of the thousands of investments being marketed daily by an army of financial consultants, stockbrokers, and insurance salesmen (yes, even they can now sell securities), in terms of results, there are just three basic types of investments.

1. Investments that protect your capital. These return your original investment dollars to you without loss, but their yields will be low. If you have a sum of money that you want to keep intact for a specific purpose, safety of principal will be a vital concern. You may want to preserve funds for your dependents after you are deceased; provide protection for funds set

maturity, the yield to maturity is considered the most accurate measure of annual investment return.

CAPITAL GAINS

There are many good features of capital gains, particularly their preferred tax treatment. First, they are not taxed until actually realized. Second, long-term gains (longer than 6 month currently) are taxed at only 40 percent of their value. Generally, capital gains are measured as an average annual compounded rate of return. An easy rule to use is the "Rule of 72" which we reviewed earlier. As you recall, we divided the number of years to double the value into 72 to obtain the annual rate. If you purchased a share of stock at $10 five years ago, and it is now worth $20, the annual compound rate of return is 14.4 percent (72 divided by 5 years).

TAXATION RULES

The correct way to calculate any investment return is to consider the effect of income taxes. For this purpose, there are three types of returns: income taxed as ordinary income at your marginal tax rate, tax-exempt income, and long-term capital gains.

For returns taxed as ordinary income, multiply the income times 1 minus your marginal tax rate: current yield x (1-tax rate)= after-tax return. For long -term capital gains, only 40 percent is taxed. Therefore the formula is:

(Capital gains x .4) X (1- tax rate) = after-tax return.

There is of course no federal taxation on tax-exempt investments such as municipal bonds or bond funds. To compare them to taxable investments we calculate what is known as a tax-equivalence rate based upon the investors tax bracket. As an example, if the tax-free yield is 5 percent, and the investor is in the 32 percent marginal tax bracket, the yield is actually worth 7.36 percent (5% divided by (1. - .32)) because of the non-tax aspect. As one's

TOTAL INVESTMENT RETURNS

The primary purpose of investing is to earn a return on your investment. This can take a variety of forms: interest, dividends, rental income, and capital gains, long and short-term. Your interest lies in maximizing your total investment return which is the sum of investment income plus capital gains. Let's look at the components of total investment returns and how we measure them.

INVESTMENT INCOME

There are three basic methods to measure annual rates of return for investment income: the nominal yield, the current yield, and the yield to maturity.

Nominal yield is the annual amount of interest or dividends paid compared with the security's par or face value. The formula is:

$$\text{Nominal yield} = \frac{\text{Annual interest or dividends}}{\text{Investment's par or face value}}$$

This rate is used only with bonds and called the "coupon rate" and with preferred stock where it is referred to as the "dividend rate".

Current yield measures the annual amount of income received from an investment compared with its current market price or value. It is normally used to measure yields common and preferred stocks as well as bonds.

$$\text{Current yield} = \frac{\text{Annual investment income}}{\text{Investment's current price or value}}$$

Yield to maturity is generally applied to bonds, and is also called the net yield, effective yield or true yield. These yields reflect the premium and discount associated with a bond when it sells at a price different than its maturity value. This difference is added (if a discount) or subtracted (if a premium) from the the bond's annual interest income, and then divided by the investment in the bond. In most cases, if the bond is held until

aside for specific purposes such as education expenses; or establish a special holding fund for special needs. While your funds are protected, remember that the purchasing power of these funds will decrease in times of inflation. Because of its structure, these investments are unlikely to enhance your wealth. For the most part they are riskless securities and historically they have provided almost no inflation-adjusted return. Examples: savings accounts, certificate of deposit, and Government-backed notes, bills and bonds.

2. Investments that provide income. These provide money for either spending or investing. Emphasis is on current yield in the form of interest and dividends. While you may desire to maximize the level of income, you must not forget that as yield goes up, safety goes down. The reverse is not necessarily true; as yield declines, safety of principal does not have to increase. Examples: Corporate bonds or high-yielding dividend stocks, income producing mutual funds or money market accounts.

3. Investments offering growth in dollar value or capital. This is probably the most popular type today. You can obtain this form directly or indirectly. When you resell the original investment above its purchases price, such as common stock or raw land, you obtain a direct capital gain. This type of investment provides capital gain and normally yields little or no income until it is disposed of. An indirect capital gain is obtained through investing in mutual funds who declare these gains yearly based upon their investment activity. Examples: Land, rental houses, growth stocks, limited partnerships.

If you are willing to forego present income for the possibility of increases in the value of your investment in years to come, then you should consider a growth-type investment. The biggest difference, other than taxes, from income producing investments is the time pattern of returns. If you rely

on a definite amount of return, you need current income for present consumption. Capital gains on the other hand, will provide the means of acquiring wealth for future consumption.

The trade-off is between investments which offer you income returns now with less growth potential versus growth investments which rely on capital gains without much income. Generally, the younger you are and the more willing you are to accept risk, the more attractive becomes growth investments. The offset to the time holding requirements and increased risk is the preferred tax treatment they receive from the IRS. Through this treatment, one is able to build for the future and not have the appreciation portion significantly reduced because of high taxes.

The safety versus income versus capital gain choice is not a one out of three decision. The selection among the three is a matter of emphasis. Many securities and funds offer a combination of two needs, and play down the third. For the majority of officers, your portfolio should possess a combination of these factors as appropriate to your situation.

PERSONAL FACTORS AND CONSTRAINTS

Investment objectives are based upon a number of personal factors that will vary among each of us. Generally, they will include: your age; your present income; your projected requirements for retirement income; the level of your retirement pay; the number and ages of your dependents; your health; your interest in money matters; your personal tastes; and so on.

Also impacting on you will be personal constraints that would influence your investment decision. Your ability to risk loss of investment income and principal; the degree of liquidity and marketability required because of pending future events (education costs, PCS, house purchase, new car, etc.); your overall tax status; and your attitudes and emotional tolerance for risk impact on how you will make your decisions. None of these constraints are bad

in themselves; you must however be consistent in applying them, and not permit your emotions to dictate your investment choices.

LIQUIDITY AND MARKETABILITY

These two investment characteristics are sometimes ignored to the detriment of investors. We generally do not think in these terms until we either need access to our funds or the financial markets turn down and we want to liquidate our investments. These two terms are synonymous and deal with the ease with which we can convert our investments into cash without significantly affecting the market price.

The protector of the last resort, the US Government, promises to pay the holder of their securities 100 percent of the value at any time. For many people, a promise of no risk, liquidity and marketability makes these types of investments very attractive. Other institutions, such as insurance companies, trust companies and banks, also have investment programs with the same characteristics, making them viable alternatives to US Government securities. As individuals, we cannot hope to match the precise liquidity of large institutions. As much of our needs for cash are unexpected, we must keep in mind the need for the desired degree of liquidity and marketability. Again, for some this need is greater than others. Where you give it up, you should be compensated by receiving either a higher yield or greater growth potential.

EASE OF MANAGEMENT

As was mentioned at the beginning of this publication, one reason military officers do not become involved with investments is the time and effort required to manage adequately an investment portfolio, especially given the volatility and complexity of the financial markets. Hopefully, after you finish with this publication you will feel more inclined to be actively involved in managing your hard earned money. There are, however investments

and investment management options which will satisfy your needs, and not require you to become an expert at investing nor consume to much of your valuable time.

REDUCTION OF EXISTING DEBT

You have probably overlooked this type of investment, yet it should receive your attention. If you use credit cards, and who doesn't these days, you may often achieve a higher return on your money by reducing the debt carried on these cards than by committing funds to new investments. The current rate of interest on funds borrowed through charge accounts, charge cards, and signature loans runs from 15 to 25 percent. I know of no investment today that is guaranteed to yield this amount. The principle is to pay down or eliminate existing debt whenever the interest cost saved is above the prospective gain on the alternative. If the reverse case exists, it pays to keep the debt. This situation is difficult to find today however; therefore consider reducing or better yet, eliminate your high cost debt each month to avoid interest charges.

WEALTH BUILDING STRATEGIES

1. There are four reasons for investing:

   a. Put inflation to work for you by maintaining the purchasing power of your monies.

   b. Increase your current income

   c. Increase your capital holdings

   d. Turn your tax liabilities into assets.

2. There are only three things you can do with your money:

   a. Spend it

   b. Loan it

   c. Investing it.

3. Four personal ingredients to investing:

   a. Time

   b. Training

   c. Temperament

   d. Money

4. Wealth is created from: MONEY X RATE OF RETURN X TIME

5. 85 percent of your investment return is attributable to the type of investment (stock, bonds, money market accounts, mutual funds, etc.).

6. The risk/return ratio affects every type of investment. Risk is key to above average returns. If no risk is taken, no tangible reward will result.

7. Savings provide the liquid foundation of any financial plan.

8. The four elements of risk differ between and among investments.

9. The financial triangle of growth, income and safety applies to every type of investment. You must choose the direction that you want to go.

10. Use the financial planning pyramid to build your investment program. Understand each type and level before your invest.

11. Evaluate all investments on an after-tax, total return basis.

SECTION VIII

FIXED-INCOME SECURITIES

There are a variety of investments which one can utilize to implement their financial plan. What will be presented is only an overview of some of the hundreds of investments available. Additional information is obtainable from books and other publications which focus upon a single type of investment. In this section, we examine fixed-income investments and how they can play a large role in your financial future.

Fixed-income investments promise an investor a stated amount of income for the "loan" of his monies for a stated period of time. Banks, credit unions, saving and loans, governments, and other financial and business concerns offer a variety of "debt" instruments either to satisfy their short-term cash needs or to provide for long-term capital needs. Over the past ten years, both markets have grown larger and more diverse.

About fifteen or more different kinds of securities are traded worldwide in these markets. This availability offer investors a variety of opportunities to meet their investment objectives. These range from pure income flows to "deep-discount" taxable and non-taxable bonds.

TYPES OF FIXED-INCOME INVESTMENTS

As mentioned, there are many types of fixed-income securities available to investors, and new ones are constantly being developed. Current types which you should become familiar include:

Preferred stocks

Convertible bonds

Bonds

"Deep discount" bonds

Municipal (tax-free) bonds

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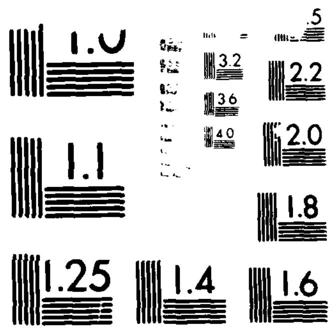
1.0
2.5
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3.6
4.0
2.0
1.1
1.8
1.25
1.4
1.6

Bond funds and unit investment trusts

US Treasury bills, notes, and bonds

US Savings bonds

Ginnie Mae bonds and funds

Certificate of deposits

PREFERRED STOCKS

From an investment point of view, preferred shares are similar to bonds. The return on the investment is fixed and usually limited to a stated amount. Unlike most bonds, preferred shares have no maturity and the shareholder is an owner, *not a creditor*. In most cases, the company is required by its by-laws to pay dividends on its preferred stock before paying anything to its common. The stock may be cumulative, participating, redeemable and convertible.

Regardless of its form, you should remember that a company or corporation has a legal obligation to pay interest on its debt, it has none to pay dividends. Because the tax laws permit the deduction of interest and not dividends, the number of preferred shares currently being offered has declined significantly.

In that preferred shares are a sort of hybrid of common stocks and bonds, they offer a middle of the road course in achieving investment objectives. Growth possibilities are not as good as common stocks, however the risk to your principal is much lower.

CONVERTIBLE BONDS

Convertible bonds sometimes offer the best of two worlds-the opportunity to share in the growth of a successful company and the security of a bond.

A convertible bond may be exchanged under specified conditions for a given number of shares of common stock of the issuing corporation. Whether the holder wishes to do so depends upon the value of the underlying stock in

relationship to the bond. If greater, the bond holder would profit from converting. If not, the holder still receives interest on the bond and the protection and safeguards of a bondholder. While this is intriguing from the standpoint of investments, the real question deals with the quality of the company which issued the bond. The criteria utilized in purchasing common stocks apply equally to the purchase decision for convertible bonds.

BONDS

A bond is a formal evidence of debt, and as such, the issuer promises to pay you a specified amount of interest at specified times and to repay the principal. In terms of your investment objectives, bonds offer the highest degree of safety of principal and income. As a creditor, you have first priority to the income of the borrower and his assets. However, by buying bonds, you limit your income and prospect of capital gain. Bonds also suffer from the effects of inflation and from taxation as ordinary interest income.

There are many various issuer of bonds, consequently the safety and income return of the bond will vary depending upon the financial condition of the issuer. Yields will vary with the associated risk. Compared with stock, most bonds are considered less risky. However, stocks tend to have a higher average return than bonds. Also, if profits made in the stock market are long-term, there are added tax advantages.

Except for the past two years (1984 and 1985), bonds have not offered growth or higher income possibilities. During the above mentioned yields plus capital appreciation, due to declining interest rates, have produced total returns of over 20 percent. Whether they will continue to produce such excessive returns over the near term is not clear.

When interest rate in the market fluctuates, the price of a bond will deviate from its par value (face value) or discount value if a discounted bond, to adjust for the differences in rates. A basic rule is that the price

or value of a bond moves in an inverse manner from changes in interest rates. If rates go up, prices come down. When rates go down, prices appreciate. Longer-term bonds are much more sensitive than shorter-term bonds to fluctuations in interest rates. The longer the bond's maturity, the greater the potential loss and the resulting decline in the value of the bond. This is part of the reason why interest rates are higher on longer-term bonds.

DEEP-DISCOUNT BONDS

These bonds sell for much less than their par value (face amount). These types of bonds are either issued as Zero-coupon bonds, or are bonds that were issued at a time when interest rates were very low.

Today, $57 will buy a zero-coupon bond worth $1,000 in 30 years. The result is the compounding of $57 for this period at a 10% annual rate. The big attraction of zero-coupons is that you can lock in a fixed return for the entire life of the bond with no problems of reinvesting interest payments at equally high rates in the future. The problem with these bonds is that you do not actually receive the interest however, the IRS taxes you as if you actually received it during each year. You should also recognize that these bonds have credit and interest rate risks similar to regular bonds.

The attractiveness of regular discount bonds has disappeared recently due to the change in their tax status. Prior to June, 1984, the difference between the purchase price and the face value ($1000 usually) was taxed as capital gains. Subsequent to the above date, the appreciation on bonds issued after this date is taxed as ordinary income unless the bond is tax-free or is issued with a maturity of less than one year.

As we will see later, zero-coupon bonds are excellent vehicles for funding education trusts for your children or for your Individual Retirement Account (IRA). They are suited well for these types of accounts because of their ease

of purchase, liquidity, interest-guarantee. Currently at this writing, their rates are extremely low, even for long-term (20+ years) bonds.

MUNICIPAL BONDS

Municipal bonds are issued by state and local governments. They have always been a favored instrument of investors in the higher income tax brackets. Today, if you are in the 22 percent bracket or higher ($21,800 for joint filer), tax-free bonds make a lot of financial sense. To indicate their value, the following chart indicates the yield from a taxable investment that would have to be earned to equal the return available from municipal bonds.

Net taxable Income (Jt.)	Marginal tax bracket	Equivalent yield needed on a taxable invest to match a tax-free bond at:		
		8%	10%	12%
$17,200	18	9.76	12.2	14.63
$21,800	22	10.26	12.8	15.40
$26,550	25	10.66	13,3	16,00
$32,270	28	11.11	13.9	16.67
$37,980	33	11.94	14.9	17.91
-9,420	38	12.90	16.13	19.35

The basic formula to determine the exact equivalent yield is the tax-free rate divided by 1- marginal tax rate. Note that the higher the individual's marginal tax bracket, the greater the advantage of investing in municipal bonds. At the same time, you must not forget that even though a bond is free of liability to U.S. income tax, this does not serve as a guarantee of its quality. Careful analysis must be made as to the sources of revenue to make interest payments, fiscal management and prior investment experiences by the issuer. Standard and Poor's and Moody's rate new issues, and their findings should be considered before purchasing any municipal bond.

Finally, be aware that municipal bond interest is not exempt from state income tax unless you own obligations issued by either the state (or its local government) in which you reside and file a state income tax return. You should also understand that when you consider total returns on municipals, only the interest portion is tax-free. Any appreciation obtained in price is taxed as capital gains, short-term if sold within six months of purchase, or long-term if held for over six months before sell. Similar rules exist for tax treatment of losses.

Most municipal bonds will be rated A or better, however, there are some lower rated or junk bonds being offered. If the bonds are general obligation, they are considered to offer a high level of security to the investor. The interest is payable from the municipality or state's many sources of revenue, plus these types are backed by the taxing capabilities of the issuer.

Sometimes an issuer borrows funds and pledges only a limited portion of its taxing power for the payment of principal and interest. These are called limited tax bonds. Usually the yields will be higher on these types due to increase credit (financial) risk.

An ever-increasing group of municipal bonds includes those issues secured by the revenues of a particular department of the municipality or of a special authority created to operate a self-supporting project. These are called revenue bonds. These type bonds generally carry a lower credit rating and a higher yield.

Two other types of municipals are housing authority and industrial revenue bonds. Congress has taken a dim view of the last type and has restricted, through the Tax Reform Act of 1985, their tax-free treatment.

If the potential default of a municipal concerns you, you should consider the purchase of insured municipal bonds. The insurance ensures the return of your principal but will reduce the yield on the bond about 1/2 percent.

BOND FUNDS AND UNIT INVESTMENT TRUSTS

The best way to benefit from bonds is through either a no-load bond fund or unit trust. They provide extra protection due to their management expertise plus greatly reduce you risk level through diversification. There are many fine no-load funds available, ranging from general purpose funds with investments in corporate, government, and municipal bonds. Other funds specialize in certain types of bonds, taxable as well as tax-free. All of these funds actively trade their portfolio holdings, consequently both their share value and yields will vary according to the market and their holdings. Their yields will also fluctuate with changes in interest rates. The longer the maturity, the greater the market risk. There are extreme differences in the safety of a funds holdings, therefore there is a resulting difference in the safety of the bond fund. Know what you are buying before you make the investment.

As an example, over the last two-three years, a new type of fund has been created to take advantage of the expanding market in what is referred to as "junk bonds". These bonds are issued by a company whose credit standing in the investment community is far below investment grade. The prices on such bonds can and will swing 20 to 40 percent within a single year. Obviously to compensate investors for accepting these risks, junk bond issues offer much higher returns.

The default rate on these bonds has exceeded 1% per annum during the past 10 years, however that rate is more than offset by higher yields of 3 to 10 percent over the highest-grade bonds. The best junk bond funds have provided exceptional returns over the past two years, however they should be utilized by only the most aggressive investors. Officers with excessive investment cash and without large future financial responsibilities should consider them

in developing the speculative portion of their investment portfolio.

Unit investment trusts select a portfolio of bonds and hold them until maturity. As the portfolio is not actively traded, the yield will be known at the time of purchase and will remain constant during the life of the trust. Usually the major brokerage houses will repurchase your units, however the value received will be based on the value of the holdings at the time of redemption. Unit trusts are extremely profitable holdings during periods of declining interest rates as the inverse relationship drives the unit value up rapidly. This appreciation is taxed as capital gains, consequently, their total return has been very attractive. Most trusts require a minimum investment of $1,000 and carry a 4 to 5 percent sales charge up front.

U.S. TREASURY BILLS, NOTES, AND BONDS

As you can expect by now, the federal government generally is accepted as having the highest degree of investment safety, consequently, the yields on its obligations will carry the lowest rates depending upon the maturity of the obligations. Rates on other securities tend to follow the rate structure set by government obligations.

Treasury bills are bearer obligations issued at a discount and redeemed at face value upon maturity. Each week, the Treasury offers three and six month bills and once a month, nine and one year bills. Treasury notes are like Treasury bills however they have a maturity of from one to seven years. Interest is paid semi-annually. Treasury Bonds have maturities of greater than seven years, and constitute the largest segment of the federal government's public debt. Interest is paid semi-annually. Interest from all of these issues are taxable at the federal level, but exempt from state income tax.

While Treasury bills can be considered riskless securities because of their short maturity, the notes and bonds do carry interest rate risk. If

interest rates rise, the price of the notes and bonds will fall as does any other fixed-income debt instrument.

To avoid the headaches of dealing directly in the government securities market, there are a number of no-load mutual funds which own only government securities. Their yield will vary depending upon the length of their holdings and the type of government securities placed into their portfolios.

U.S. SAVINGS BONDS

U.S. savings bonds, Series EE, are registered, noncallable, and nontransferable securities. They are issued in denominations of $25 to $10,000, are issued at a discount, and pay no current interest. The amount of effective interest earned depends upon the length of time between the issue date and the maturity date. Currently, if you hold the bond for five years or greater, the minimum interest rate guaranteed to you is 7.50 percent. They will also pay interest equal to 85 percent of the average market yield on other Treasury securities.

These bonds have been used by some for gifts or for financing educational requirements for their children, however, with rates 15 percent below the rates offered by other Treasury issues, savings bonds are not recommended for current purchase. Other investments such as zero coupon Treasury bonds provide you with a much higher yield without an increase in risk.

If you do purchase these bonds for your children, be careful not to purchase them in joint ownership with your social security number on the bond. It will be taxable to you and not your child. The best way to gain tax advantages from the bond is put it into your child's name, and file a tax return only in the first year. This filing indicates the intent to declare the interest yearly with the IRS, and because there is not usually any taxes due because of the child's personal exemption, no additional returns are required.

If you elect,however, to accrue the interest, you will be faced with a tax payment when you sell the bonds.

GINNIE MAE CERTIFICATES

Ginnie mae certificates offer the best of both worlds- the safety implicit in a US Government guarantee, and a significantly higher current yield than other government backed investments of equal risk. The Government National Mortgage Association (GNMA) is a government-owned corporation that guarantees the timely payment of interest and principal on certain mortgage-backed securities. While it is difficult for individuals to purchases Ginnie Mae's directly, there are numerous opportunities through 10-15 mutual funds who specialize in this market.

While everything looks attractive, there is one major drawback: uncertain maturity of the underlying mortgages. In periods of falling interest rates, homeowners prepay their mortgages and refinance at lower interest rates. The reverse happens when rates go up, prepays decline. Because of this uncertainty, Ginnie Maes yield 1 to 2 percent more than funds holding only other government securities. The best funds, those with low or no sales and redemption charges and no hidden load charges, are very competitive investments in comparison with corporate and government bond funds. A word of caution- watch the yield rates!

CERTIFICATE OF DEPOSIT

CDs' are one of the favorite savings vehicles of small and medium-sized investors. The key feature of a CD is that the rate of interest is defined in advance and is certain. On the other hand, CDs'are usually not redeemable prior to maturity without a substantial penalty. For this reason, they are not recommend for funding of your short-term liquidity account. They are however suitable for asset accumulation and protection purposes if the yields are competitive with other similar investments.

CDs´ from federal insured financial institutions are insured up to a maximum of $100,000 per individual. CDs of institutions with state supported deposit insurance are also protected, however recent events indicate that these insurance agencies would not provide you full protection. It is best to avoid state-chartered institutional CDs´.

As with any other fixed-income investment, CDs are subject to inflation, especially, if the maturity is long-term. You loose if you sell when interest rates go up in reaction to inflation and you loose through decreases in real purchasing power. Unless you absolutely can not accept any investment risk, other investments will currently provide you with higher quality interest returns.

STRATEGY FOR INVESTING IN FIXED-INCOME SECURITIES

Fixed-income investments provide similar qualities in each of the three basic investment characteristics of safety, liquidity, and yield. Because of their common characteristics, each of these securities is a partial substitute for another. To the extent that these substitutions can be made, there is the opportunity with a little effort to improve your overall yield by shifting funds among various fixed-income instruments. The key differential is the yield spread, the difference between yields on different securities.

One of the ways to monitor this situation is to watch overall interest rates on key interest rate instruments such as the Money Market interest rate index published weekly, the Federal Discount rate, and the yield curve on US Treasury issues. All of these rates can be found in the **Wall Street Journal** or the financial pages of major newspapers. When interest rates begin to decline, you should extend the maturities on your holdings and conversely, they should be shortened when interest rates are expected to rise. By doing

so, you will be able to reposition your funds into the highest yielding securities.

You should keep the yield spread between municipal bonds and/or funds and comparable taxable funds and bonds in mind. As rates currently continue to drop, this spread is at the lowest in the last twenty years. This drop also gives rise to capital gain appreciation as the value of the bonds continue to rise in reaction to the interest rate decrease. The after-tax return of the municipals may be higher than the comparable taxable bonds.

Fixed-income investments should have a place in your portfolio. You should use them to satisfy your goals and objectives involving the need to accumulate funds for investment, for any education requirements, to provide a specific level of continuous income flows, and in some cases, for your IRA.

WEALTH BUILDING STRATEGIES

1) Fixed-income securities provide a stated amount of income for the "loan" of an investor's monies.

2) Fixed-income securities possess the basic investment characteristics of safety, liquidity, and yield, are easily substituted between themselves, and can fill a large variety of income-oriented investment objectives.

3) Municipal bonds (and funds) provide tax free income for those investors in the 22% marginal tax bracket and higher (O-4's and higher).

4) Zero-coupon Treasury bonds are excellent investment choices for gifting to children and other low income persons and for financing educational requirements.

5) Understand the true structure of Ginnie Mae returns before you invest.

SECTION IX

COMMON STOCKS

"Common stock" is defined as the residual ownership of a corporation with the rights to all assets and earnings after other claims have been paid. Because a corporation is a legal entity, shareholders are in a position of limited liability, that is, they are not liable for the debts of the corporation.

If you invest in the common stock of a corporation, there are certain rights that you have in addition to the one cited above. They include:

- the right to sell your share
- the right to vote to elect corporate directors
- the right to attend shareholder meetings
- the right to examine the company's books
- the right to share in profits by receiving dividends declared by the board of directors
- the right to share in the assets of the company on dissolution.

The term "par value" refers to the price or value printed on the stock certificate at the time it is first issued. It is the value assigned to each share of an issue of par-value stock. This value is used to determine the maximum amount that can be recorded on the company books when all shares are issued. Par value does not have any relationship to the stock's market value, so do not get the two terms confused.

As a common shareholder, you do not have the first claim on assets and earnings of the company. You will find yourself behind all creditors and preferred shareholders. Therefore, the board of directors may or may not pay dividends to the common shareholders. For this reason, common stock is

classified as a variable-dollar investment.

Common stock offers three advantages. First, you can participate in the economic growth of the company, either through receipt of dividends and/or increase in the market value of the shares. Second, common stock offers you the opportunity of capital growth. Third, common stock acts as a good long-term hedge against inflation. Historically, over the long-run, stocks have outpaced inflation. Recall our chart a few pages earlier which reflects this point. Remember also that stocks do not guarantee the principal nor the rate of return, however the biggest risk is being out of stocks, not being in them.

CATEGORIES OF COMMON STOCK

There are several categories of common stocks which you should be familiar. While there may be different classifications utilized by others, the following focuses on a breakout based on the investment grade or "quality" of stocks: blue chip, growth, income, defensive, cyclical and speculative.

Blue chip stocks are generally considered to be high-grade, investment quality issues of major, well established companies such as General Motors, IBM, AT&T, etc. One of their characteristics is to pay steady dividends over bad years as well as good for a long period. Another is a long history of good earnings in good and bad years. When one speaks of the "DOW", this is the general class of stocks contained in this popular market index.

Growth stocks can also include the blue chips' depending upon their growth rate. To be in this category, a company must have sales and earnings expanding faster than the general economy, and faster than most stocks. The company is usually aggressive, research minded, and plows most of their earnings back into the company for future growth. Growth companies pay small dividends resulting in low (4-7%) yields. Investors hope for substantial capital gains over time to drive up the share price.

To become good at selecting growth stocks, you must be aware of current

events: current trends, supply, demand, psychology, and money markets. The days of buying only blue chip or income stocks and putting them in the drawer are over. To be successful, be current as stated above, be in the right industry at the right time; buy experienced management; hold stocks with self-generating, consistent, year-after-year earnings; produce high return on equity; and which are leaders in fast-growing fields. Easy said but hard to do consistently!

Because of these variables, the market price of growth stocks can be quite volatile. They will often go up in price faster than other stocks, but can decline equally as fast. The key to watch is the rate of increase in a stock's earnings over time.

Income stocks produce current income, usually at a rate which exceeds money market or bond interest yields. As we have repeated several times, a stock which pays high interest may be doing so because of its strength or because of its difficulties. When economic conditions weaken, current income generally becomes more popular to investors than during an expanding and strong economic cycle. The best income stocks have a long unbroken dividend history, and do not pay excessive yields which jeopardize your principal.

To be classified as a defensive stock, the stock must be able to maintain its market value during periods of economic declines. They also suffer little during periods of recession or cyclical waves in the economy. Companies which provide the essentials of life fall into this category, such as utilities, banks, savings and loans, insurance companies, and food companies.

Cyclical stocks are those whose earnings tend to fluctuate sharply with the business cycle. When business conditions are good, the company's profitability is high and the stock price is high. When conditions reverse, so does profitability and stock prices because sales will dry up. These type

of stocks are strongest in the earliest stages of a business upturn. Auto manufacturers and tool companies are examples.

Speculative stocks are the glamour, high-flying developmental companies which attract investors because of their potential. Generally, they are identified by their high Price/Earnings (P/E) ratio. During periods of extreme "hot" markets, these stocks will pace the market. On the other hand, these same stocks decline even quicker when the market moves lower.

STOCK PRICES

The major determinant of the price of a common stock is the law of supply and demand. If there are more investors who wish to buy a stock than there are stockholders who wish to sell, the supply and demand for the stock is out of balance and the price will rise until someone is willing to sell. As the price goes higher, the number of people who wish to buy the stock decreases, and, so at some level, there is a temporary balance between these two factors. This balancing varies from day to day as the company's prospects change and as the mood of the market place changes.

While this sounds simple, given the "hype" that stockbrokers and investment counselors proclaim over their "unique" trading systems and inside knowledge, a stock is "worth" only what someone else is willing to pay for it at a given time. Always keep in mind that there is always two sides to every stock trade: for every buyer there is a seller, and for every seller, there is a buyer. This basic idea determines the underlying value of a stock and is what makes the stock market function. The question of value is however pervasive.

WAYS TO INVEST

There are a variety of ways to invest in stocks. The most interesting, but the most risky is to do it yourself. To do so will require a lot of time and research, not to mention the continuous requirement for building

knowledge. At the same time, there is a lot of research materials available, such as **Standard and Poors, Value Line, Moody's, The Wall Street Journal and Barron's,** magazines such as the **Financial World, Forbes, and Business Week.** You should use a discount broker if you choose this method to invest. The cost is much reduced from the commissions charged by full-service brokers.

The second way is to make use of full-service brokers. You will gain the benefit of professional advice, however expect to pay for it through a commission charge and/or stock price markup. For some, a good stockbroker can be well worth their costs. The ability to find and keep one when we relocate as often as we do is difficult. Unless you are a big trader, there is always the question of whether you derive any tangible benefits from the broker, especially given his inherent conflict of interest. While there are many good ones, remember that a broker makes his money by selling you stocks and other investment vehicles. You can avoid this problem and cut your transaction costs significantly by utilizing "discount" brokers who charge only for executing your trades, however provide no investment advice.

Regardless of how you invest in stocks, there are several major considerations you should look for in selecting stocks for your portfolio:

1. The company selected should be in a growth industry. This is identified as one whose rate of sales growth is expected to increase faster than increase faster than the national average during periods of expansion and decrease more slowly than the national average during periods of recession.
2. The company should have management who has demonstrated the ability to translate sales increases into profit increases and has given firm evidence that it can recognize and act on opportunities. Nothing beats good management and a superior product together.

3. The company should pay out no more than a small portion of its earnings in dividends on stock; uses the bulk of its earnings to finance future growth; has large capital expenditures; high depreciation charges; a low direct cost as compared to total production cost; and the ability of passing on cost increases to the consumer through price increases.

4. Avoid stocks who have reached their peak of popularity. Never buy on tips and when growth stocks are out of favor.

5. Select stocks with low P/E's, high earnings growth rates, and low price-to-book value.

6. Make use of fundamental analysis to determine the value of a stock by examining factors that determine its expected future earnings and associated volatility (risk). Fundamental factors basically affect the company and its earnings.

7. Invest in stocks which will provide you the best possible total return on your capital.

8. Spread your risks by diversification, and constant supervision of your holdings.

9. Remember that there is an essential inter-relationship between people's moods and actions of the markets. As this relationship determines the direction of the market, you must stay current and constantly reappraise new conditions as they occur.

STOCK RIGHTS AND WARRANTS

An investment closely associated with common stocks are stock rights. A right is a privilege granted to a shareholder to buy new shares for a limited time at a price usually below the prevailing market price at the date the rights are issued. Many times, the rights are tied to a specific number of shares, i.e. one right for each 100 shares purchased.

Once you are granted a right, you have three choices:

1). do nothing

2). exercise it

3). sell it

What you do will generally be determined by their value which is tied to the market value of the underlying common stock.

Warrants are very similar to rights. They are options to buy securities at a given price. The biggest difference is the longer length of the term for exercising warrants. The warrant can be attached to the stock, or detached and sold separately.

WEALTH BUILDING STRATEGIES

1) Common stocks are classified as variable-dollar investments because of the uncertainty and volatility of their dividends. In return for this risk, a shareholder is provided the opportunity for capital growth and protection against inflation.

2) Common stocks are classified by their risk/reward relationship:

-Blue chip

-Growth

-Income

-Defensive

-Cyclical

-Speculative

3) Become knowledgeable of the stock market, individual stocks and stockbrokers before you begin to invest.

4) If you decide to invest in common stock, insure that you reduce your risk levels by diversifing your portfolio.

SECTION X

MUTUAL FUNDS

Mutual funds are made to order for military officers. They provide a solution for every reason why we haven't been more active in creating wealth. These reasons, which apply to the majority of us, are time, temperament, training, and money. Let's look at each of these:

TIME

Our job pressures, and time constraints impact on much of our working day. Few of us have the time required to study market trends, economic indicators, consumer and business buying trends, international monetary markets, individual stock status, and so on. In the absence of time, mutual funds are the answer to your needs.

TEMPERAMENT

Are you mentally prepared to become involved into the complexities of the investment world? Can you act properly and promptly on new and changed market conditions? Are you temperamentally suited to accept risk to your hard earned monies? If you can answer yes to these type questions, then acting as your own investment manager may be best for you. If you answered no to these questions, the best way to participate in the wealth building process is through mutual funds.

TRAINING

What is your investment training background-accounting, statistical analysis, economics, finance, behavior analysis? If you possess this training and have the time, you should still consider making your own investment decisions. If not, mutual funds make good sense.

MONEY

Do you have enough money to diversify your investment holdings? One of the first rules of investing is to diversify- spread your holdings into a variety of instruments. This can be obtained if you have $15,000-$20,000 to invest. There are some financial experts who say that one needs much more, $50,000, so that the investor can effectively eliminate the majority of the risk associated with any one investment vehicle. They cite the number 10 as being the least number of different holdings by which the majority of this risk is eliminated.

These four aspects are key to your decision as to the role you personally want to play in the investment program. Unless you can answer yes to all four, I would strongly recommend that you make use of the best professionals to manage your investment dollars. I think you will agree after you look at the results that some good full-time pros have produced.

WHAT IS A MUTUAL FUND?

A mutual fund is an investment company that pools monies from a large number of individual investors and invests these funds into a variety of investment vehicles such as stocks, bonds, US Treasury issues, etc. Many different types of funds exit, with varied investment objectives. These funds also differ in the degree of success they have achieved in meeting their stated investment objectives.

Another variant between funds is the expense structure; some funds charge a commission to purchase the fund, while others do not. They all incur commission expenses in buying and selling of securities and have overhead and administrative expenses which will vary depending upon the fund.

WHY INVEST IN MUTUAL FUNDS?

Mutual funds overcome the problems we identified earlier, the 3Ms + T. Given the number and diversity of the 1200+ funds, this investment vehicle

should be the core of your wealth building program. Funds offer these advantages:

1. **Diversification.** The investment Companies Act of 1940 requires a mutual fund to limit itself to not more than 5 percent of its assets in any one company, nor own more than 10 percent of the shares of any one company. Consequently, the pooled holdings of diversified stocks, bonds, etc. spreads the risk of one or more investment going bad among all of the other holdings.

2. **Transaction Costs.** As funds are large purchasers and sellers of securities, they pay less than one fifth the cost per share paid by the average investor. This means that more of your investment is working for you.

3. **Professional, full-time management.** Successful investment is a full-time job. Given the dynamics of the world economies, the fortunes of the market place as well as that of individual companies can change very rapidly. It takes professionals to follow these changes and search out the information necessary for making the right decision.

4. **Convenience.** Mutual funds have a plan for everyone. You can start an investment program with a relatively small amount of money; some funds do not even have a minimum. All funds permit automatic collection and disbursement of dividends, interest, and capital gains. You have the option of receiving these disbursements or automatically reinvesting them back into the fund. You can vary how you desire to receive these, reinvest all, reinvest only the dividends, or receive the distribution in cash. The fund will keep track of each transaction for you plus provide monthly or quarterly statements and information for annual tax purposes.

5. **Liquidity.** On any business day, the investor can liquidate or purchase additional shares at a fixed price. You can determine the daily price, bid and ask, through the financial pages of newspapers. Additional, there are

many financial publications which continuously review and rate the funds.

6. **Overwatch.** Funds are monitored by the Securities and Exchange Commission and other federal and state agencies.

7. **Investment Alternatives.** In addition to making periodic purchases, funds accept investments through bank draft authorization for monthly investments or by dollar-cost-averaging methods where the investor makes a monthly purchase directly from the fund.

8. **Full Services.** Most funds offer a variety of different funds for regular, individual retirement accounts (IRA) and other types of retirement plans. You can deal directly with the fund or through your broker to make purchases, withdrawals or transfers with little delays.

9. **Special Funds.** Funds exits today that cover the spectrum of specialty investment needs. You can invest in foreign stocks, stock options, precious metals, and any variety of bonds as an example.

10. **Exchange Privilege.** Regardless of the type fund in which you invest, fund management grants you the privilege of exchanging from one fund to another, generally without a commission or fee charge.

11. **Timing.** In addition to the ability to change funds if your investment objectives change, you also have the opportunity to move in and out of the market without a commission. If the market turns down, you may want to move your risk funds into money market accounts. Unlike the cost of selling stock, you can make this move commission free. This feature makes the "family of funds" concept particularly attractive because of the wide offerings available to an investor within a particular investment company.

LOAD VS. NO-LOAD FUNDS

This is one of the fundamental questions investors must decide when purchasing mutual funds. The distinction is that load funds involve a sales charge of 8-9 percent of your investment and are purchased from stockbrokers

or from salespersons. No-load funds are purchased directly from a fund sponsor and permit all of your investment to work for you.

Which is better? A multitude of academic studies have determined that load funds do not perform any better than no-load funds. In essence, the two types perform equally well or poorly. Yet, there are consistent winners on both sides who outperform the market averages year after year. These are our only candidates for consideration.

Experiences indicate that the key expense in fund ownership is rarely the sales charge or load. More likely, for the long-term investor, the management fee is the greater expense. No loads generally charge a small percentage more. however, management fees tend to vary according to fund size, whether or not the fund carries a load. The average fee is about $1.05 per $100 of fund assets, with an average cost of $1.42 for funds with assets under $25 million to $.72 for those with assets over $250 million. However an interesting point is that the best funds generally have some of the lowest management fees. You need to keep this in mind when evaluating your fund candidates.

One class of mutual funds that has risen to prominence in recent years is the 12b-1 fund. This is a no-load fund when purchased, but a fee is charged at time of sell if the fund is not held for a specified period, typically five years. While the typical fund charges approximately a 1 percent fund, 12b-1 funds can charge a liquidation fee plus an operating fee of as much as 2.25 percent each year. The difference-1 percent versus 2.25 percent- can mean a fortune in compounding power lost each year.

In evaluating no-load funds, you need to carefully examine the fee structure to insure that you are not falling into the "12b-1" trap. If you believe that you will hold the fund for a long period of time, you should

avoid these type of funds. Similarly, even if you hold the fund for a short period of time, the higher charge will affect your total return.

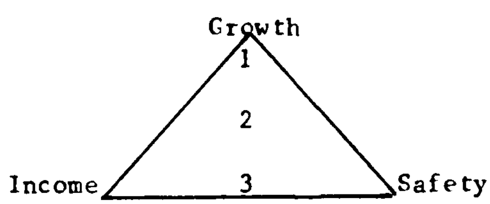
Experiences indicate that you will do better by staying with true no-loads with low management fees. No-load funds are identified in the financial listings with the letters "NL" in the offer column.

The only real disadvantage that exists with no-load funds is it takes time and effort on your part. Using a broker or investment advisor puts the responsibility on them, however there is a steep fee charged for their effort. Utilizing the funds recommended will not only save this fee, but earn, over the long-haul, above average returns.

MUTUAL FUNDS AND THEIR INVESTMENT OBJECTIVES

There are mutual funds available to meet just about any investment goal. It is important to remember that the basic rules on risk and reward apply to . fund investing. A fund must state in its prospectus its financial .jective. This objective determines the risk level that you would incur when you invest in the specific fund. The concept of "family of funds" mentioned earlier helps reduce the overall risk level because you can relocate your investment easily from one fund to another with a simple phone call as either your investment objectives or market conditions change.

As you recall the financial triangle looks like this:



The important thing to remember is that you can't go in very direction. When you maximize income, you move further from growth. The same if you select safety as the primary objective.

Let's look at the basic definitions of the primary types of funds:

1. **Growth funds.** A mutual fund whose primary investment objective is long-term growth of capital. It invests primarily in common stocks with growth potential greater than those represented in major stock indexes, such as the Dow Jones Industrial Average. You should expect little or nothing in the way of dividends from these funds as indicated by their location on the triangle at #1. Subdivisions of growth funds are funds which aim only for maximum capital appreciation of the fund's share price, growth and income funds which combines growth with high dividend paying stocks, and funds which invest in only small, emerging companies.

2. **Balanced funds.** A fund which has an investment policy of "balancing" its portfolio, by including bonds, preferred and common stocks, seeking to maintain greater stability of both capital and income. Typically, the stock-to-bond ratio is 60% to 40%. A derivative of a balanced fund is an equity-income fund which seeks high current income. Unlike a balanced fund which has to invest in bonds, the equity-income fund may invest in bond if market conditions warrant it. Both of these type funds provide downside protection during declining markets because of the dividends and income earned on its portfolio. These funds lie around #2 on the triangle.

3. **Income funds.** These funds provide current income to their shareholders. They generally invest in common stocks, preferred stocks, and bonds (taxable and tax-free), with high current yields as their investment goal. Their location is at #3 however, they can move toward either income or safety depending upon the quality and maturity of the funds' portfolio.

4. **Specialty funds.** These funds concentrate on the common stock of funds in particular sectors of industries, services, or even regions of the country. There have been a great expansion of funds into this area, giving the investor choices from many different sectors of the economy, however they are less

diversified than funds that spread their investments over many industries.

5. **Global or international funds.** These type of funds invest in stocks of international or foreign companies. Their objective is to provide the opportunity to diversify one's investment holdings and take advantage of markets independent of those here in the United States.

6. **Dual funds.** These funds are really two funds in one. They allow investors to concentrate on either capital gains or current income. Thus, half of a dual fund's shares are sold as capital shares and the other half as income shares. The capital shares receive any appreciation from the fund's portfolio, while the income shares receive all the income.

CHARACTERISTICS OF FUNDS

The following matrix lays out the important characteristics that you should understand:

Objective	Type	Investment Policy	Capital Appreciation	Safety of Income	Safety of Principal
Current income plus principal protection	Money Market	Money Mkt. instruments	None	Low	Very high
Current income	Bond funds	Bonds; preferred stock	Moderate	Stable	Low to Moderate
Current income and conservation of capital	Balanced	Stocks and bonds	Moderate	Moderate	Moderate
Capital Appr.	Growth	Stocks	High	Moderate	Low
Income and Capital Appr.	Growth and inc.	Stocks	High	Moderate	Low to Moderate
Aggressive Growth	Aggress. growth	Stocks	Very high	Low	Very low

As you can see, the options are almost unlimited. The key however, is to pick the best from the fund groupings which meet your objectives. At the end of this section, you will find a listing of the best 100 funds for the past 10

years. A checkmark (✓) is placed by the best buys for each category at the time of this writing.

SELECTING A FUND

Your question now is, which one? There are no easy or sure answer, but here are a few ideas that will help you:

1. See if the fund's objectives and investment policies meet with your own objectives. There are many funds to choose from-your job is to find the right "fit".

2. Consider the fund's past performance in light of its objectives. Use the analysis found in financial magazines or in the fund guides located in your library. Look at long-term performance-5 and 10 years, not last months winner.

3. Determine, as best you can, the qualifications and experience of the people in management who are managing the fund's portfolio. Usually this information is found in the fund's prospectus.

4. Consider all sales charges and management fees carefully. There is no need to invest in a fund with excessive fees and charges.

5. Consider the various shareholder services the fund makes available to you, including: the right to make low, periodic additional payments, reinvestment of dividends and capital gains at no cost, exchange privileges at no cost and the available of other funds with other investment objectives.

READING A PROSPECTUS

The answers to the above questions are found in the fund's prospectus. Unfortunately, many fund investors do not take the time to read this important document before making an investment. This is certainly a mistake. Before making an investment in any fund, you should first request and read the simplified prospectus, along with the accompanying documents such as the annual report, latest quarterly or semi-annual report.

The fund's prospectus contain three sections that spell out what management will do with your money. First, the "Investment Objectives and Policies" section covers the objectives and strategies employed to meet these. As you know by now, each fund uses different means to accomplish their goals.

Next, look at the section on "Risk Factors". We also know that a fundamental principle of investing is that investment return is always accompanied by investment risk. The greater the anticipated rewards, the greater will be the assumed risks.

Next, review the listing of the fund's investment restrictions. The Investment Company Act of 1940 limits the investment activities of diversified open-ended investment companies (mutual funds). Some funds place additional restrictions on the activities of their investment managers.

We now need to determine what the fund management intends to do with your money. You will want to check and see how well its past actions have conformed to its basic policy statement. The easiest way to check on performance is through use of one of the many fund reporting publications. To determine the costs of the fund, check the sections on "Purchase and Redemption of Capital Stock", "Marketing Expenses", "Investment Advisor", and "Portfolio turnover". The total historical costs are summarized in the "Statement of Income and Capital Changes".

To determine the tax treatment of the fund's distribution, you want to refer to the "Dividend and Federal Tax Status" section. You should note the frequency for which distributions will be made along with the approximate distribution dates. Most funds distribute at least 90 percent of their net income and realized capital gains. It is important that you do not, repeat, do not want to buy into a fund just before a distribution, because you will be taxed on it while having paid full value for it in the fund price; in other words, you will be receiving back your own money less taxes. When you file

your income tax return, you will have two types of mutual fund income: dividends and capital gains distribution. The fund will tell you the specific breakout for tax purposes.

The purpose of the fund prospectus is to provide investors with information regarding the investment they are about to undertake. While the prospectus is often written in legal jargon, a careful reading is a requisite to long-term investment success. Don't invest until you investigate!

TAX CONSEQUENCES OF OWNING MUTUAL FUNDS

Mutual funds are merely conduits of income to their shareholders, and are only taxed on their undistributed income. For this reason, shareholders need to insure that they understand and incorporate tax implications into their fund investment strategies.

The general rule regarding mutual fund distributions is that investors are taxed on all distributions in the year received. This is true whether or not the distributions are actually received or reinvested automatically by the fund. The period of holding has no effect upon this rule.

The taxation of mutual fund distributions depends on the source of the income to the fund. If the fund received dividends from stocks it holds, interest from bonds, or long and short-term capital gains from the sale of securities, their tax treatment is provided to the investors on IRS Form 1099-DIV. In some cases, portions of the dividends may qualify for a dividend exclusion of $200 for joint filers. Long-term capital gains distributions are taxed at the preferential long-term capital gains rates regardless of how long the investor has been a mutual fund shareholder.

From a tax-planning aspect, an investor should not purchases mutual fund shares immediately before a fund declares a distribution. If he does, he will subject part of his initial investment to immediate taxation, thereby causing

a lower after-tax return on his investment.

WEALTH BUILDING STRATEGIES

1) Mutual funds are designed to resolve investment management problems of: Time, Temperament, Training, and Money.

2) Select on the best no-load mutual funds as the foundation of your wealth accumulation efforts.

3) Know and understand the different types of mutual funds.

4) Know the key points of how to read and evaluate a prospectus.

5) Incorporate tax implications into your investment strategy. Understand how funds are taxed.

Source: Investment Inst. of America

TOP MUTUAL FUNDS

✓ : BEST BUYS

TELEPHONE #	FUND NAME	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	3 YEARS 1983-1985	5 YEARS 1981-1985	NOTES: Sales Load	NOTES: Redemption Fee	NOTES: Tel Switch
312-621-0630	Acorn Fund ✓	64.4	17.9	16.7	46.8	27.9	-6.7	16.3	25.0	4.5	31.5	71.8	87.0		2%	X
800-821-5591	Babson Enterprise Fund	—	—	—	—	—	—	—	—	-5.0	38.6	N/A	—			X
800-821-5591	Babson Growth Fund	14.5	-7.3	8.7	17.2	27.8	-6.0	14.7	15.8	3	29.6	50.5	62.3			X
617-482-0795	Beacon Hill Mutual Fund	11.3	8	8.4	8.3	26.6	1.9	12.7	16.6	3.8	33.5	61.6	85.6			
800-343-6324	Boston Co. Capital Apprec	16.7	-5.1	8.2	19.5	26.9	-3.6	10.5	24.0	6.9	35.0	78.9	90.6			X
800-343-6324	Boston Co. Special Growth	—	—	—	—	—	—	—	39.6	-10.9	34.7	67.5	—			X
800-431-6060	Bull/Bear Equity Income	28.2	9.5	3.7	16.8	29.7	-7.1	15.9	11.9	7.7	25.8	51.8	66.8			X
800-321-1928	Century Shares Trust ✓	36.3	-2.1	9.2	20.0	5.7	19.0	9.9	21.1	15.6	42.6	99.7	161.1			
214-980-1800	Charter Fund	41.8	5.2	32.3	44.0	33.7	1.4	15.6	19.3	-5.7	25.5	41.4	65.0			
800-547-1037	Columbia Growth Fund	30.5	-0.1	7.7	39.2	33.9	-3.4	34.7	21.4	-5.1	32.0	52.1	97.9			X
212-986-1370	Constellation Growth Fund	23.0	-3.6	21.1	76.8	74.5	-17.1	12.0	24.6	-15.2	28.6	35.9	26.2			
800-221-5672	De Vegh Mutual Fund	16.1	-4.4	5.2	29.8	42.0	-11.7	8.4	14.9	-6.8	28.6	37.7	31.8			
415-981-1710	Dodge Cox Balanced Fund	25.0	-3.3	5.8	13.4	20.7	-2.4	24.1	16.8	4.7	32.5	62.0	96.3			
415-981-1710	Dodge Cox Stock Fund	22.0	-6.1	9.1	20.3	32.1	-2.3	20.6	26.5	5.2	37.8	83.4	116.1			
800-645-6561	Dreyfus Growth Opportunity	39.0	7.0	20.0	44.9	49.1	-14.2	1.6	31.1	-12.1	30.7	50.6	31.3			X
800-645-6561	Dreyfus Special Income Fund	19.1	6.0	1.4	15.4	16.5	1.0	14.2	20.8	7.7	23.8	61.1	85.8			X
800-645-6561	Dreyfus Third Century Fund	23.5	13.0	10.3	56.5	38.9	-10.4	2.2	20.0	1.6	29.7	58.1	44.8			X
800-635-0003	Evergreen Fund	48.9	25.1	38.0	39.7	43.8	-1.4	16.6	29.7	6	35.2	76.4	102.8			X
800-635-0003	Evergreen Total Return Fund ✓	—	—	—	21.1	24.4	8.5	22.5	29.8	14.4	31.5	95.3	159.5			X
800-544-6666	Fidelity Contra Fund	35.8	-10.1	6.0	25.6	28.1	2.6	14.5	23.2	-8.3	29.6	43.5	72.0			X
800-544-6666	Fidelity Discoverer Fund	—	—	—	18.5	28.8	7.1	35.2	32.2	-8.7	22.1	47.4	113.4			X
800-544-6666	Fidelity Equity Income Fund ✓	44.1	4.8	11.2	30.0	28.8	8.4	29.9	29.1	10.8	25.0	78.8	151.8	2%		X
800-544-6666	Fidelity Freedom Fund	—	—	—	—	—	—	—	—	3.3	28.7	—	—			X
800-544-6666	Fidelity Fund	24.5	-3.3	8.9	17.7	32.1	-3.4	26.5	22.2	1.4	27.7	58.2	93.4			X
800-544-6666	Fidelity Magellan Fund ✓	37.5	14.3	31.5	51.4	67.8	16.5	44.8	38.2	3.0	43.1	103.7	243.6	3%		X
800-544-6666	Fidelity Mercury Fund	—	—	—	—	—	—	—	—	-5.5	39.8	—	—	3%		X
800-544-6666	Fidelity Puritan Fund	29.6	8	4.6	14.5	19.2	10.3	25.8	25.3	10.5	28.5	77.9	146.9			X
800-544-6666	Fidelity Trend Fund	21.1	-3.3	9.7	26.4	26.5	-5.2	13.3	26.6	-2.2	28.2	58.7	70.5			X
800-525-8085	Financial Dynamics Fund	31.4	7.8	6.2	42.4	21.9	-.5	36.9	13.3	-13.8	29.1	26.1	71.7			X
800-525-8085	Financial Industrial Fund	29.4	2.6	7.5	36.6	24.3	-14.2	36.9	14.4	-1.2	28.4	45.1	70.5			X
800-525-2440	Founders Growth Fund	7.4	-4.8	11.8	37.1	50.3	3.6	21.4	19.4	-11.1	28.8	36.7	72.0			X
800-525-2440	Founders Special Fund	16.9	12.8	6.9	53.7	51.6	-12.9	30.2	23.5	-12.2	15.2	24.9	41.7			X
800-235-3322	Ivy Fund	18.0	-7.3	4.6	30.0	33.6	5.7	30.8	29.6	7.9	29.4	80.9	150.2			
800-525-3713	Janus Fund	20.1	3.5	15.8	34.6	50.5	7.1	30.6	26.1	-.1	24.5	56.8	119.4			X

TELEPHONE #	FUND NAME	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	3 YEARS 1983-1985	5 YEARS 1981-1985	NOTES Sales Load	NOTES Redemp-tion Fee	NOTES Tel Switch
800-822-5544	Legg Mason Value Trust	—	—	—	—	—	—	—	42.6	12.7	31.8	111.8	—			X
800-221-5350	Lehman Capital Fund	—	24.8	24.1	40.9	36.0	7.3	35.7	37.6	3.9	27.2	81.8	164.8			X
800-221-5350	Lehman Investors Fund	16.6	-3.8	11.0	27.5	25.9	-.4	25.7	23.7	-.3	26.3	55.8	95.0			X
800-526-0056	Lexington Research Fund	25.5	-6.9	6.6	30.2	20.5	4.9	10.4	28.6	-4.3	26.3	55.4	80.0			X
Closed Fund	Lindner Fund	52.2	29.8	22.8	27.9	28.9	34.0	26.1	24.6	12.8	19.4	67.8	183.6			
Closed Fund	Loomis Sayles Capital Fund	18.9	-.5	24.0	26.8	39.0	2.8	62.5	15.3	-8.2	46.2	54.7	158.5			X
800-223-7124	Loomis Sayles Mutual Fund	15.8	-4.0	4.7	13.3	14.3	-.2	38.5	9.7	6.3	34.4	56.7	116.6			X
312-236-8215	Mathers Fund	43.7	13.9	14.2	40.3	37.2	-7.3	12.9	15.9	-2.4	27.5	44.2	50.9			
800-523-0864	Medical Technology - (Pro)					48.7	-7.7	37.7	-.2	-12.5	38.8	21.2	54.1			X
800-858-3013	Mutual Shares Corp.	55.2	15.4	18.3	42.8	18.5	8.7	12.7	37.1	14.5	26.6	98.7	142.6			
800-858-3013	Mutual Qualified Income	—	—	—	—	—	22.2	15.4	34.9	14.7	25.6	94.3	174.1			
800-367-0770	Neuberger Energy Fund	32.2	2.3	6.0	48.0	39.9	-11.0	1	22.2	4.8	22.5	56.9	39.5			X
800-367-0770	Neuberger Guardian Fund	34.9	1.3	8.4	35.4	28.0	-4.9	27.7	25.1	7.4	25.3	68.3	104.4			X
800-367-0770	Neuberger Manhattan Fund	10.0	-9.4	7.3	33.6	36.1	-7.0	27.6	26.6	7.1	37.1	85.9	120.6			X
800-367-0770	Neuberger Partners Fund	30.9	6.9	16.4	42.4	30.4	5.6	24.6	19.0	8.2	29.9	67.3	120.1			X
800-221-5672	Neuwirth Fund	17.7	-2.0	9.7	24.4	47.2	-13.0	27.4	14.2	-9.5	39.4	44.1	59.7			
800-247-7039	Newton Growth Fund	19.4	1.4	8.4	25.0	45.3	-1.8	36.1	23.5	-8.2	28.7	45.9	95.0			X
Closed Fund	Nicholas Fund	22.7	20.3	25.3	30.5	34.2	8.7	31.9	23.4	9.9	29.7	75.9	152.2		1%	
414-272-6133	Nicholas II Fund	—	—	—	—	—	—	—	—	16.8	33.8	—	—		1%	
617-357-8480	Omega Fund	50.0	3	7.3	35.8	37.5	-8.1	-9.5	21.9	-.5	32.3	60.5	33.5			
603-431-8022	Pax World Fund	24.7	2.3	-.3	18.7	16.3	1.0	16.8	23.9	7.2	28.2	70.3	100.9			
Closed Fund	Pennsylvania Mutual Fund	49.0	23.7	16.1	35.1	22.4	0	25.4	40.4	3.3	26.5	83.5	130.1			
800-523-8440	Penn Square Mutual Fund	32.9	-6.1	3.7	20.5	23.7	1.1	17.9	29.0	.5	26.6	64.1	95.6			X
800-221-5672	Pine Street Fund	25.1	-3.4	4.9	19.5	32.4	-7.5	18.5	19.0	5.2	31.0	63.9	79.8			
800-638-5660	Price Growth Fund	12.8	-7.0	11.2	11.1	28.8	-12.1	15.5	11.7	-1.2	35.2	49.2	51.5			X
800-638-5660	Price Growth + Income Fund	—	—	—	—	—	—	—	32.4	2.0	19.7	61.6	—			X
800-638-5660	Price New Era Fund	20.9	-4.0	11.2	56.2	50.2	-14.9	5	25.3	3.5	23.3	59.9	36.8			X
800-638-5660	Price New Horizons Fund	11.0	12.6	20.5	35.0	54.8	-7.6	17.5	19.4	-7.4	24.2	37.3	49.1			X
800-523-0864	Pro Fund	17.0	7.3	15.1	24.4	15.1	-8.6	21.0	7.4	5.3	22.9	39.0	53.7			X
800-221-5672	Quasar Fund	46.0	17.0	27.4	56.4	56.4	-6.3	24.8	33.8	-10.3	49.0	78.8	109.2			
Closed Fund	Royce Value Fund	—	—	—	—	—	—	—	43.0	.2	27.6	82.1	—			
800-426-6730	Safeco Equity Fund	35.0	4.9	10.7	25.9	26.8	-4.8	10.1	21.2	3.3	31.9	65.1	73.1			X
800-426-6730	Safeco Growth Fund	58.7	16.0	18.0	33.7	29.8	-2.1	18.6	31.6	-7.0	20.5	47.5	71.2			X
800-225-2470	Scudder Capital Growth Fund	23.9	7.7	20.8	26.2	32.2	-6.3	28.8	22.4	5	36.6	68.0	102.8			X

TELEPHONE #	FUND NAME	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	3 YEARS 1983-1985	5 YEARS 1981-1985	NOTES Sales Load	NOTES Redemption Fee	NOTES Tel Switch
800-225-2470	Scudder Development Fund	22.7	25.0	30.0	29.7	46.3	9.1	14.9	18.1	-10.3	19.7	26.8	59.0			X
800-225-2470	Scudder Growth + Income Fund	24.8	-1.6	10.7	22.9	33.9	5.8	18.8	13.4	-4.5	34.5	45.7	63.0			X
800-621-7321	Selected American Shares	20.4	3	3.3	8.7	20.4	-1.0	22.5	21.4	14.9	33.3	85.9	125.5			X
800-621-7321	Selected Special Shares	15.6	-6.6	1.3	26.0	23.0	-7.2	16.2	27.8	-4.2	23.7	51.4	63.3			X
Closed Fund	Sequoia Fund	70.8	19.3	23.5	11.9	12.0	19.7	27.9	26.9	18.4	27.9	92.2	194.2			
Closed Fund	State Farm Growth Fund	39.3	3.4	12.1	43.5	25.4	-3.9	19.7	15.5	-1.6	34.0	52.3	75.2			X
800-621-0320	Stein Roe Capital Opport	24.6	5.7	16.4	50.9	73.5	-14.9	23.4	12.1	-16.8	24.6	16.2	22.0			X
800-621-0320	Stein Roe Discovery Fund	—	—	—	—	—	—	—	—	-12.2	45.3	—	—			X
800-621-0320	Stein Roe Special Fund	22.2	14.8	6.4	47.2	46.2	-10.7	31.3	33.0	-1.2	29.4	70.0	99.4			X
800-621-0320	Stein Roe Stock Fund	16.3	-8.6	7.0	28.2	60.9	-19.9	29.6	14.0	-9.8	26.5	30.1	35.0			X
800-621-0320	Stein Roe Total Return	14.8	-5.7	6.5	16.7	26.8	-13.0	22.3	13.4	5.3	25.6	50.1	59.6			X
800-621-0320	Stein Roe Universe Fund	—	—	—	—	—	-9.0	31.8	20.3	-18.7	28.3	25.5	50.5			X
215-542-8025	Stratton Growth Fund	39.7	2.0	7.3	18.0	31.3	-6.7	31.5	26.0	-4.8	27.4	52.8	87.5			X
800-368-3863	Strong Investment Fund	—	—	—	—	—	—	33.2	44.7	9.8	19.4	89.7	—	1%		
800-368-3863	Strong Total Return Fund	—	—	—	—	—	—	32.5	40.7	10.4	25.4	94.8	—	1%		
800-223-3332	Tudor Fund	23.8	6.4	20.2	27.4	43.2	8.8	44.5	28.0	-7.2	31.2	55.8	145.0		1%	X
816-531-5575	20th Century Growth Fund	61.1	13.8	41.7	63.5	63.0	-5.8	8.5	24.4	-10.2	33.9	49.6	52.9			
816-531-5575	20th Century Select Fund	27.8	24.5	34.5	40.7	45.1	1.0	40.9	29.9	-7.6	33.8	60.6	128.5			
816-531-5575	20th Century Ultra Fund	—	—	—	—	—	—	30.2	26.3	-18.9	26.2	29.3	—		5%	
800-862-7283	Unified Growth Fund	20.1	1.4	19.0	28.8	34.0	-7.5	28.0	11.5	3.9	26.0	46.0	72.8			X
800-862-7283	Unified Mutual Shares	24.0	-3.7	6.6	22.5	23.0	-7.0	18.0	21.7	8.5	30.8	72.7	89.5			X
800-223-0818	Value Line Fund	42.8	9.5	19.3	46.0	42.0	2.4	29.0	-1.3	-14.8	34.6	13.2	49.5			X
800-223-0818	Value Line Leveraged Growth	46.9	51.5	27.6	23.9	25.8	13.1	22.6	8.0	-8.9	27.1	25.1	73.4			X
Closed Fund	Vanguard Explorer Fund	17.1	28.2	20.4	33.8	55.4	2.0	41.2	20.5	-19.5	22.5	18.8	71.1			
800-662-7447	Vanguard Index Trust	—	-7.8	5.9	17.8	31.1	-5.2	18.5	21.3	6.2	31.3	69.1	90.0			
800-662-7447	Vanguard Morgan Fund	19.0	7.2	18.3	16.5	33.8	-4.6	23.3	28.1	-5.1	30.1	58.2	86.0			X
800-662-7447	Vanguard Wellesley Fund	22.6	4.2	3.5	6.4	11.3	8.2	21.8	18.6	16.6	27.4	76.2	132.2			X
800-662-7447	Vanguard Wellington Fund	22.7	-4.5	5.1	13.3	21.9	2.5	23.3	23.4	10.8	28.5	75.7	122.0			X
Closed Fund	Vanguard Windsor Fund	45.2	6	8.5	21.7	21.4	16.1	20.7	30.0	19.5	28.0	98.8	178.7			X
800-662-7447	Vanguard-World US Growth	—	—	—	—	—	—	—	—	—	36.6	—	—			X
212-986-1370	Weingarten Equity Fund	16.4	18.7	26.7	50.3	60.0	-12.1	24.0	28.9	-6.1	36.1	67.7	79.5			
800-223-3332	WPG Fund	—	—	—	—	29.6	-5.6	29.8	17.8	-1.6	30.2	50.9	84.9			X

Results for each year are reported in total percent of change in NET ASSET VALUE of each share. All distributions paid by the fund (income and capital gains) have been added back in determining the NET % CHANGE FOR THE YEAR. A minus (-) sign is a loss. No sign is a gain for the period.

SECTION XI

TAX SHELTERS

Tax-sheltered investments can apply to many kinds of investments, from the tax-free(deferred) buildup of life insurance cash value and Series EE savings bonds to the interest on municipal bonds. Generally, when we speak of this term, it means certain specialized kinds of tax-favored investments, such as real estate, oil and gas, cable TV and certain farming operations.

Due to intensified scrutiny by the IRS lately and efforts by Congressional tax reforms, the continued attractiveness of shelters is questioned. Despite the unsavory image, you don't have to be either crooked or unpatriotic to invest in these vehicles. Many of them are economically sensible, operate entirely within the law, and are offered by demonstrably sound promoters.

TAX INCENTIVES

Tax shelter investments can be an extremely successful method of creating wealth. A good tax shelter will enable you to use dollars that you would otherwise pay in taxes to acquire investments that will increase your net worth. Their benefits derive primarily from legislation, structure and deferral and compound interest. Shelters are perfectly legitimate in principle: they exist because Congress passed laws to encourage investment in high risk ventures such as real estate, and oil drilling. The government has extended tax incentives to private investors in order to promote public interest and satisfy social needs. Some of these tax incentives are:

1. Accelerated depreciation and amortization
2. Deferral of taxable income through current income tax deductions
3. Use of current income tax deductions to shelter and offset other taxable income
4. Special statutory deductions, such as the oil and gas percentage deduction

5. Taking returns as long-term capital gains.

These tax incentives generally do not eliminate taxes; they simply defer them to a later time period. By creating tax losses in earlier years, the investor gains several advantages:

1. The deferral of tax gives the investor the use of the tax dollars for a period of years before paying them without interest.
2. The deductions may be taken when your tax rate is high and when the income is finally recognized in later years, your tax rate will be lower. This possibility is enhanced if the current tax reform efforts in Congress to reduce the highest tax bracket to 35 percent goes through.
3. When these losses are claimed in later years as income, they are generally taxed at favorable long-term capital gain rates.

FINANCIAL STRUCTURE OF SHELTERS

The financial structure of a shelter can be divided into four segments:

1. Tax benefits
2. Cash flow
3. Capital appreciation
4. Risk

There is a close interrelationship between these segments. If we divided these into equal parts of a pie, and then changed any one segment, one or more of the other three segments would also be changed. The benefit to an investor is that the value of each sector can be estimated, therefore permitting the choice of a shelter which fits their objective.

TAX BENEFITS

Based upon the structure of a shelter, one is able to receive deferred and compounded interest on their investment over the life of the shelter. This is possible because of tax benefits, particularly during the early portion of the

life of the shelter, will offset any interest earned on the investment. In some cases, the tax benefits not only offsets the interest earned, but also creates a taxable loss. The investor's interest continues to accrue tax free until the properties are sold at long-term capital gains rates.

CASH FLOWS

Most tax shelters incorporate some form of leverage and availability of deductions that require no investor cash to obtain. Leverage is a term used to describe a situation in which you control a large investment with a relatively small amount of your own money. The rest is financed with someone else's money, however you get the benefits, such as interest deductions, on the entire investment.

On the opposite side of leverage is the issue of risk. When inflation decreases, causing real estate prices to soften, the expected appreciation required to pay off the leveraged (loaned) amount may not exist.

Tax shelters normally provide one of the following cash flow deductions:

1. Depreciation. This is the recovery of the capital cost of equipment or a building over a period shorter than its estimated useful life. The recovery period for equipment and real property was significantly reduced by the Tax Act of 1981 to three and fifteen years respectively. Since that year, Congress has yearly pushed the depreciation period outward. Real property can now be depreciated over a nineteen year period with current efforts under the Tax Reform Act of 1985 to increase it to either twenty five or thirty years.
2. Depletion. This is similar to depreciation but applies to recovering the cost of such assets as oil, coals, and other minerals extracted from the ground.
3. Intangible drilling costs. In oil and gas programs, deductions are available for labor, fuel, supplies and other items that have no savage value but are necessary for drilling wells. Such deductions can range from 50 to 90

percent of the investment in the first year.

RISK

While tax shelters are attractive to those in high income tax brackets, there are several pitfalls one should be aware of:

First, they are of a specialized nature in areas where the average investor is not familiar. Consequently, the ability to judge the quality of an investment is limited.

Second, the ability, reputation, character of the promoter and his financial participation in the deal is important. The degree of participation can be determined from the prospectus of a public offering by determining where the proceeds are to used and who is providing them. Additionally, you want to make sure that your general partners are experienced with a proven track record and a history of sound investments.

Third, what fees are to be paid? If your investment is to be reduced by 10-15 percent for sales and general partner fees, forget the deal. Similarly, if acquisition fees to buy property can cut into your investment. Stay away from any partnership with acquisition fees above 4 percent for an unleveraged real estate program, or 16 percent for a deal with 50-75 percent leverage. Oil and gas deals charge much lower fees, with 12 percent being the limit on fees.

Fourth, in that many tax shelters are sold as limited partnerships, you must realize that in exchange for not being liable for the debts, obligations, and losses of the partnership, the general partners have the legal and exclusive right to manage and operate the partnership outside of your control.

Fifth, look beyond the tax benefits of the investment. You must be sure that the shelter makes sense economically. "Good tax deals" no longer work in the eyes of the IRS. Given the fact that the top tax bracket is currently 50

percent, and the majority of military officers are in the 30-40 percent bracket, it makes absolutely no sense to give away or lose .50 to .70 cents on the dollar. Think about that for awhile if you don't understand.

Sixth, high interest rates may make many tax shelters questionable investments. With many current shelters being highly leveraged, the high cost of money can impact on the economic viability of the shelter.

Seventh, tax shelters are high risk, long-term investments with very limited liquidity and marketability. Once in a shelter, it is extremely difficult to extract yourself whole from it. Consequently, the financial posture of the general partners, their pattern of making sound investments, and how much do the sponsors plan to borrow are relevant questions to ask early on.

Eighth, if the deal does make money, who gets what, and what is a fair sharing arrangement? There are many ways for this to be done; be sure to review *in detail the specifics* in the shelter's prospectus. Generally, in real estate, the general partner receives 1-2 percent while the limited partner 98-99 percent until the limited partner has recovered the original cash investment and then the sharing arrangement changes to a 25-30 percent to 70-75 percent split at time of sale of the property. Where the general partner has made a large contribution to the equity of the partnership, they are obviously entitled to a larger share of cash flow and other profits. The point is that the general partners should not be at less risk than the ordinary investor.

Lastly, changes in the tax laws over a period of time can significantly affect the economics of the shelter. Current tax reform proposals under discussion would make tax shelters less attractive. A top bracket of 35 percent combined with the possibility that deductions would be limited to the amount at risk (your investment), and an extended depreciation period would

cut into the economics of any shelter. Grandfathering could possibly help, however who knows the will of Congress.

TYPES OF TAX SHELTERS

Historically, real estate has been the predominate shelter in that it provide a combination of tax advantages plus income and capital gains. Generally, your home could act as a shelter when you PCS, or you can participate through a limited partnership with many other partners. In both cases, tax laws permit the pass-through of the earnings and deductions directly to you for inclusion in your annual tax return.

The at-risk rules, which limit loss deductions to the amount an investor has at risk, does not apply to real estate. Consequently, real estate investments are usually leveraged to maximize their total returns. There are numerous types of real estate partnerships ranging from all income producing to highly leveraged tax-oriented ones. The key question in either type is whether the investment will provide you with after-tax returns which exceed other types of investment, commensurate with the given risk.

Recent studies indicate that real-estate partnerships handly outperformed inflation during the 70s and early 80s. Taxpayers in the 38 percent bracket received an average annual after-tax return of 13.2%. This level of performance has not continued over the last two-three years primarily because inflation has been significantly lower, therefore holding prices down.

Oil and gas investments are the riskiest of the shelters, however they can yield handsome returns if extremely successful (and lucky). With oil prices currently headed for $15 and lower, the economics of oil and gas do not now make much sense. Therefore I do not recommend further consideration, however from a contrarian viewpoint, this may in fact be the time to buy. My preference would be to wait until oil prices head back up. There will be

plenty of opportunities to get in at a low cost.

The third type of shelter is equipment leasing. These shelters buy anything from computers to medical equipment to airplanes, and lease them to corporations or government agencies. The one tax benefit which made these shelters attractive, the investment tax credit, is under attack by the Reagan administration and Congress. If it is stricken from the tax code, I don't see this type of shelter as being viable for consideration.

Other type of shelters include cable TV, and mining operations. They each have their particular tax features and advantages/disadvantages which do not apply to the majority of us; therefore we will not cover them. If interested, you should contact a professional advisor.

TAX SHELTER EVALUATIONS

Investors who are interested in tax shelters are encouraged to obtain as much independent analysis as possible on any prospective investment. One of the best reviews is the Stanger Register, published monthly by the Robert A. Stanger and Co., 1129 Broad St. Shrewsbury, N.J. 07701. This report list and evaluates all current public partnership offerings. Another excellent publication on tax shelters is the Brennan Reports (P.O. Box 882, Valley Forge, Pa. 19482). Either or both of these is well worth the purchase price.

Another source of tax shelter analysis are the brokerage and financial planning firms. Many sell as well as operate the partnerships. My caution to you is to remember, your broker makes his money by selling.

IS A TAX SHELTER A GOOD INVESTMENT?

Tax shelters make sense only if your portfolio of other investments, not including your home, is worth more than $40,000. Even then, you should be sure that you won't need these invested funds for the term of the partnership, 4-10 years normally. The biggest risk of these investments is their illiquidity-it is difficult to get out without losing a portion of your

investment. A final caution is that, if you decide that this investment if for you, avoid any partnership that doesn't make strong economic sense on its own merits, regardless of tax benefits. If it doesn't, stay out!

WEALTH BUILDING STRATEGIES

1) Understand the financial structure of tax shelters:

- Tax benefits
- Cash flow
- Capital appreciation
- Risk

2) Ensure that all other steps of the financial planning model has been accomplished before considering aggressive tax shelters.

3) Understand that Congress is currently attacking tax shelters with the intent to eliminate their tax advantages.

4) Study and understand what you are being sold by investment companies and syndicators before you invest. If you don't understand it, don't. If you do, have a CPA or tax lawyer evaluate it.

SECTION XII

LIFE CYCLE INVESTMENT PLANNING

One of the basic principles of sound financial planning is the systematic conversion of income to capital. To reach financial independence, you must convert a portion of your present income, through regular savings and investments, to capital. Consequently, you should begin to execute a strategy, utilizing the principles of investing, to accumulate capital assets. In doing so, we need to recognize that the two follow-on phases of this concept- the preservation of capital where we protect our accumulated assets and the disbursement or estate planning phase where we begin to make plans and initiate actions to pass assets to family members- are dependent on how well we do during this phase.

To assist in the first phase, you should complete Forms 14 through 16 in Part II. The information there will be the guiding light in building a capital portfolio to start you on your way toward financial success. Our intent is to establish a solid financial base through directing your existing capital into a limited number of areas, then gradually building on this base with other investments from future cash flows. By taking this approach, you will become more comfortable with your investment decisions thereby raising your risk-reward tolerance level. This in turn will expand your financial knowledge, creating the opportunity to investigate additional investment vehicles which may be appropriate for you.

A CHANGING PLAN

In designing the asset accumulation portion of your financial plan, you must be prepared to make your plans in such a way that they can be altered periodically to suit new circumstances. Consequently, the term, life cycle

investment management. At every stage of your life, your investment strategy should properly reflect your changing lifestyle and circumstances. Your choices that suit you today may not suit your circumstances two or five or ten years from now.

In way of review, you recall that regardless of your investment goals and objectives, your investment portfolio will have one or more of the following features: safety of principal, income returns, future appreciation, liquidity, risk minimization, and tax efficiency. Your task is to select those investments according to these characteristics which are most important to you at the time.

Whether you take an aggressive or defensive approach to your choices will be dependent upon the many considerations that we have discussed in detail earlier. While none of us are blessed with the vision to foresee the future, the fact that we are putting together a plan of action to reduce the risks of the future is certainly better than no plan at all. At least we have a start, one which can be changed as required. You should feel comfortable with this.

CONSTRAINTS

In section VII, we talked in detail on the point that everyone is faced with constraints that affect their daily lives as well as their financial affairs. These conditions, similar to our investment goals and objectives, will change over our life. Our task is to ensure that we have properly identified them and take them into consideration as we initiate our financial programs. Key constraints center around our investment psychology, our acceptance of market and financial risk, our tax status, children's education requirements, source and consistence of income, housing requirement, current and future, and age. There are more which you should include in your planning efforts.

SELECTION OF INVESTMENTS

To help start the process of selecting the types of investments that best meet your objectives, while recognizing your constraints, you can use the following type of matrix. Remember, 85 percent of the after-tax return on investments is due to the type of investment. Consequently, your effort during this first phase of life cycle investment planning, asset accumulation, is very critical to your financial future.

Investment Objectives	Priority High	Priority Medium	Priority Low
Safety of principal			
Income			
Liquidity			
Future appreciation			
Inflation hedge			
Ease of management			
Tax savings			

Investment Constraints	Priority High	Priority Medium	Priority Low
Home requirements			
Children's education			
Financial/market risks			
Constant income			
Tax status			
Psychological			
Other			

By completing this type of matrix, you can select the type of investments which best fits to your objectives and constraints. As I have mentioned several times, there's no such thing as a sure thing. If you keep in mind the relationship of risk to reward, your odds of success are greater.

ALLOCATION OF INVESTMENT DOLLARS

By now you are aware of the many investments to which you can allocate your investment funds. To give yourself maximum control over your conflicting objectives and constraints, you will want to apply the principle of diversification when choosing your investments. Diversification will help offset any losses that may result from a bad investment decision. The spreading of risk among a number of types of investments as well as diversifing within each class or type will provide you the greatest degree of protection against the various types of risk.

Diversification can also help you in dealing with your investment constraints. For example, if you need income at certain times of the year, you can provide it by arranging your portfolio accordingly-including short-term investments that mature at diverse and appropriate times. This form of diversification helps you fight the interest-rate risk, since you will continually have funds available to invest at current interest levels.

There is a real need to diversify. According to recent academic studies, 70 percent of total investment risk can be diversified away. This risk, called unsystematic risk, is associated with the unique characteristics of any one investment vehicle, i.e. a specific stock. You eliminate this form of risk by the holding of a number of stocks. In the case of mutual funds, the fund portfolio manager accomplishes this by holding a large number of investment vehicles. The remaining 30 percent, systematic risk, can not be diversified away. This risk is inherent in the market place, i.e. stock market, and affects all similar vehicles, i.e. stocks. Consequently, you

have the opportunity to significantly impact on your wealth maximization efforts by dividing your funds between a number of investment vehicles across the spectrum.

PORTFOLIOS FOR ALL AGES

We will now present a series of "type" portfolios which will fit the majority of military officers. These are based upon the author's personal as well as professional experiences. They are not intended to dictate a requirement, however they represent the general types or classes of investments which will provide you with the best changes to obtain financial independence. The percentages for each investment goal should be adjusted to fit each individuals own situation.

	Investment Goal			
Approximate age period	Income	Capital Appreciation	Safety	Speculative
24 to 35	20-30%	40-50%	15-30%	5-10%
35 to 50	15-20%	55-70%	10-20%	10-15%
50 to 65	40-50%	20-30%	10-30%	10-15%
Above 65	50-70%	10-20%	10-35%	0-5%

Obviously, these percentages should be accepted as guidelines only. At a young age, you will have the income and opportunity to begin to accumulate assets. For young military officers, the biggest variables will be the working talents of the spouse and whether there are children. Regardless of the answer, this is the time where paying yourself pays off. The aim should be on long-term capital gains combined with the creation of a solid safety net(short-term liquidity funds) to handle emergencies and discretionary costs.

During the age period of 35 to 50, we are well into the field grade ranks,

and beginning to maximize our earnings; we have one or more children; and our wife is probably not working (for profit at least). During this period, financial considerations are of the highest order of importance. The first and most compelling aspect of financial planning will be the protection of spouse and children in case anything happens to you. If the recommendations in the section on life insurance were accepted, you should now be attempting to accumulate and protect as much in the way of capital assets as possible.

Because you are moving into a high income tax bracket, you need to insure that your investments are being protected from taxes. This means using no-load mutual funds with capital appreciation and growth-income objectives, tax-free municipal bond funds and unit trusts, and a limited amount of tax shelters. In addition, you should have funded any education expenses through a variety of investment means which we will discuss in the next section. Your standard of living will decline if you do not make plans many years before the funds are required.

During the 50 to 65 age period, you have already retired from the Armed Forces and found another job, obtained very senior military rank, or completely retired. This period occurs when your earning power has neared its peak, however your overall expenses are reduced because your children are finished with college. This time should be used to establish your retirement income. Once your children need little or no financial support, you will begin to have funds to invest in income-producing assets. During this period you may also find that your insurance needs have diminished, therefore creating additional funds that can be dedicated toward retirement funding. Consequently, you may now want to shift your investment strategy toward a more conservative, safety oriented approach. Your objective is to insure that you have sufficient funds to supplement your retirement pay and Social Security benefits(assuming it is still available). The portion of your assets that you

leave in capital appreciation investments is for your estate and support to your family. How much depends on what their needs are after you pass away.

After you pass age 65, a comfortable income during retirement is one of the primary goals. The level of this comfort during your "golden years" will be determined by your success in planning and self-discipline during your working years. For most people, it requires an early start, investments suitable to the various stages of your life, and a great deal of determination.

In the next section we will address your future asset requirements such as preservation of capital and income to fund specific needs such as retirement, education, home purchase, travel, job change, etc.

WEALTH BUILDING STRATEGIES

1) Life cycle investment planning is composed of three interrelated phases:

- Accumulation of capital assets
- Preservation of capital assets
- Distribution of estate assets.

2) Each individual's investment plan and portfolio changes overtime due to changes in personal factors and constraints.

3) Each investment portfolio requires the proper "mix" of investments containing the characteristics of:

- safety of principal
- income yields or returns
- future appreciation
- liquidity
- risk minimization
- tax efficiency

4) Diversification is needed to avoid investment disasters. Eliminate 70

percent of investment risk by holding a number of the best no-load mutual funds. Minimize the remaining risk by choosing the best yielding total return funds with minimum volatility.

5) No-load mutual funds should serve as the basis for life cycle investing.

SECTION XIII

MEETING FUTURE FINANCIAL REQUIREMENTS

This section is designed to assist in answering the question of how to effectively plan for future financial requirements. For the majority of us, these will primarily consist of planning for retirement and education cost coverage. For a few, other long-term requirements will exist such as planning for travel, purchase of a new residence or vacation home, or to start a business venture. Regardless of the specific reason, the strategy for meeting these requirements will be the same; only the means will vary. In the next two sections, we are going to concentrate on the most important of these future capital requirements, retirement and education funding.

PLANNING A RETIREMENT INVESTMENT STRATEGY

During your time on active duty, the major objective of your investment program is to accumulate capital. As you put into play the principles and recommendations previously discussed, you should be on your way to the accomplishment of this objective. The second phase of the lifetime investment cycle is to preserve the value of the capital you have accumulated and use it for the maximum production of income which will be used later to supplement your retirement pay and social security benefits.

The critical point which you must understand is that the sooner you start planning for retirement, the better. Simply because this is called phase two of the lifetime investment cycle, you should not wait until accumulating the necessary level of capital for retirement before beginning to think about retirement funding requirements. The reason is that the same investment principles we used to maximize our efforts to accumulate capital apply:

RATE OF RETURN X TIME X MONEY.

Starting now is the only way to guarantee your financial future.

It would be a mistake to believe that military retirement pay will completely satisfy your financial needs after you leave active duty. Even if they appear to meet them, can you say for sure that you will receive what you have been promised: do you know that Congress has eliminated the Cost of Living Allowance (COLA) from both military retirement pay and Survivor's Benefit Program? What will be your future eligibility for CHAMPUS or even Social Security? These uncertainties plus the fact that we all are living longer clearly indicates the requirement to look hard at providing for your retirement needs independently of what has been promised by the government. If you don't need it, fine, at least it would be available for you to enjoy the "golden years" in a grand life style.

Without adopting a morbid outlook toward the possibility that Congress will, in fact, tinker with our retirement program, central to retirement planning is the military retirement plan as we now know it. You should use the current system as a starting point for developing your investment strategy. Remember that one great advantage that we in the military possess is that you can't outlive these retirement flows. As you will see, however when you begin complete the forms in Part III, the dilemma we could possibly face is how to replace the loss of the cost of living allowance (COLA) after you retire.

Let's look first at the amount of monthly retirement pay that we would currently receive under the present retirement plan:

	RANK			
Years	05	06	07	08
20	$1758	$1943	$2537	$2806
24	2183	2467	3044	3435
26	2364	3010	3552	3721
30	2728	3345	3932	4294

As one can easily see, these amounts will not provide the level of income flows required to maintain your desired standard of living. The reason for this "gap" is that military personal do not retire on 50 percent or higher of final pay and allowances; it is closer to 35-40 percent because allowances such as BAQ, BAS, flight pay, specialty pay, etc., terminate upon retirement.

To close this gap will require a combination of solid financial planning strategies plus, in the majority of cases, a second job or career. The Retired Officers Association has calculated that the mean starting salary for an officer obtaining his first civilian job after 20 years of active service is $25,000. The mean salary for all officers-not just starting salaries- is between $30,000 and $33,000. They also calculate that an 0-5 at 20 years service will need to earn $63,000 a year to equal what he would have earned if he stayed on active duty and retired as an 0-6 at 30 years. For one who is already an 0-6 at 20 years, the breakeven point from retiring before completion of 30 years is $85,800. Obviously, each of us have different value to the civilian community, however, we need to be realistic in what we will earn during a second career.

Our task here is not to discuss financial aspects during retirement, but to develop satisfactory financial plans to insure that when you do retire from active duty, there isn't a decline in our living style regardless of the economic value of any second job or career. This will require action on our part. Don't leave your financial future to others regardless of promises.

PITFALLS TO RETIREMENT PLANNING

The two greatest impediment to effective retirement planning is the failure to calculate the effects of inflation and taxes into your plans. Until recently, military retirees were somewhat sheltered from the effects of inflation through the annual cost of living allowance (COLA) adjustment. In 1986 a unique event occurred. The promises of yesterday that no military

retiree would be worse off because of loss of purchasing power through inflationary effects were forgotten by both Congress and the Executive Office when the Gramm-Rudman Balanced Budget Act was signed into law.

Whether this will turn out to be a temporary restriction is unknown at this time; the fact that promises that have been upheld consistently for years have been currently stricken from the books should be of concern to each of us. Consequently, you should be prepared on your own to protect yourself and not leave your financial future to others.

If you ask why, let me remind you of some earlier computations. Even if, as we discussed, inflation was held to 3 percent a year, it would take $1,340 in 10 years; $1,625 in 15 years; and $2,080 in 20 years to replace $1,000 in purchasing power. Without a COLA adjustment, your ability to maintain your living standard will be hard pressed unless you begin to make plans now.

Similar effects are created by taxation. While no one knows what the tax laws will be in the future (not even Congress!), one can easily assume that he will be faced with an annual tax bill. Given this, your objective is to take steps to reduce this tax burden by taking advantage of the laws through legal, prudent tax strategies. To help offset the negative effects of inflation and taxes, we must develop a strategy which produces total returns which annually exceed inflation and which utilizes a variety of investment options which minimize the tax impact. Again, to create this strategy, we need to insure that we consider our objectives in terms of our circumstances and goals. Once we ensure that our objectives are clearly defined, we are in a position to consider those investment options which satisfy them.

RETIREMENT INVESTMENT OBJECTIVES

In creating our strategy, we need to consider five investment characteristics:

- SAFETY: As you build your asset base, your top priority should be to preserve its value. This is normally the top investment priority because the opportunity to make up for market place losses is limited, especially as you near or enter retirement. At the same time, your definition of a "safe" investment may range from a bank savings account to what someone else would consider speculative. This range of investments that may be classified as "safe" is wide. To decide on the types of investments that have the degree of safety you are looking for, you have to consider the four types of risks to investment values: loss of purchasing power, financial, market, and interest risks. We've covered each of these earlier, so you should review this material again.

As you also recall from the financial triangle, concern over safety leads to the most conservative approach to investments. You pay for safety with the loss of potential income, from inflation, taxes and possibly from the wrong choice of investment. For example, you should not be buying long-term fixed rate bonds when interest rates are moving up. Short-term CD's and money market funds would be more appropriate. Similarily, when rates are at what appears to be a high, a move into longer term bonds, CD's or T-notes would be prudent.

- YIELD: Investment dividends and interest will become a high priority as you move toward retirement. As you recall, yield as an investment objective has two components-current income and total return from capital accumulation. As you increase your need for retirement income, you should seek out those investments with the highest total returns, consistent with your acceptable risk level. No-load mutual funds will play a very important role in satisfying this requirement as will long-term bonds and CD's. As warned before, you should watch out for retirement annuities with a fixed payout for life. As you know by now, a fixed-income investment that cannot be changed is

a disaster in today's economic environment. Not only do you run an inflationary risk, at your death, your dependents will inherit the same capital value and income from it that you had. What's bad for you is bad for them!

-LIQUIDITY: If you plan to live on a tight budget, liquidity should be a major priority for you. Hopefully you won't suffer this fate, however, the need for some liquidity should be recognized. You can easily obtain this by constructing a widely diverse investment portfolio as recommended.

-GROWTH: Investing for growth is inherently risky; but if you want to build your retirement base, you will have to accept some degree of risk. How much is a personal matter. While it is our character to minimize risk, we take as much risk in investing in sure things such as passbook accounts, below market CD's, etc. as we do in high quality no-load mutual funds. At least we create the opportunity to beat inflation and taxation, which we don't do through these sure things such as fixed-income investments.

-REDUCE TAX LIABILITY: High taxes have been a major stumbling block in trying to accumulate capital for retirement. Beginning in 1981, this has changed somewhat. The 81 tax act provided some excellent opportunities for enhancing pre-retirement capital accumulation and income flows. For all of us, it permitted tax-deductible contributions to Individual Retirement Plans(IRAs). There hasn't been a better retirement vehicle created for not only military personnel but for all working Americans.

This same tax act also expanded opportunities in other retirement areas such as reducing the depreciation periods for real estate and cutting back on the capital gains tax on equity investments.

WEALTH BUILDING STRATEGIES

1. Your military retirement pay, will not by itself, provide the income necessary to maintain your established living style.
2. The earlier you start funding your future asset needs, the better.
3. The keys to wealth are: **Rate of Return, Time, and Money.**

SECTION XIV

INDIVIDUAL RETIREMENT ACCOUNTS

The real question that you must ask yourself is not whether to establish an IRA but how best to fund it. This is the most important element because of the attributes of an IRA. Nowhere will the payoff be larger than selecting the proper investment vehicle to fund the account. Over time, the difference will be significant. For example, $2000 will grow to $3,222 in five years and $5,187 in ten years at 10 percent compounded interest. The same $2000 will grow to $4,023 in five years and $8,091 in ten years at 15 percent. Similar differences are found if you make yearly investments of $2000 for a period of 20 years with annual returns of 15 percent: $126,000 vs. $235,620. If you were fortunate enough to obtain an annual return of 30 percent, your earnings would amount to $1,638,000 in 20 years. Best of all, no taxes are charged against these compounding yields until you withdraw the money.

The rules for IRAs are fairly simple:

1. You must have taxable compensation from wages, salaries or self-employment income.
2. Payments are deductible up to the lesser of:
   a. $2,000
   b. your earned compensation included in gross income for the year.
3. Payments must be made by April 15th to be deductible against the prior year's taxes.
4. Contributions can be made for a spouse if:
   a. You were married at end of year.
   b. You had sufficient taxable gross income equal to the contribution.
   c. Your spouse had no earned compensation during the year.
   d. You filed a joint return for the tax year in which you make the

payment.

e. The maximum deductible amount for a husband and nonworking spouse is $2,250. This amount can be divided anyway desired as long as no one person is credited with more than $2,000 in each year.

5. Distributions may begin at age 59 1/2, or earlier if disabled. all amounts received are treated as ordinary income.

6. Early distributions (before 59 1/2) are considered premature, are included in gross income, and are subject to a 10 percent tax penalty.

7. One can have as many IRA accounts as desired. To switch an account, two procedures are available:

   a. Rollover- Funds are withdrawn from an existing account, received by the investor, then reinvested into a new IRA within 60 days of receipt.

   b. Transfer- A request is made to the old IRA trustee for a direct transfer to a new IRA. No time limit exists as the investor does not handle the account funds.

8. Prohibited transactions:

   a. Borrowing money from an IRA.

   b. Investing in collectibles such as gold.

TAX BENEFITS

The twin tax breaks IRAs provide translate into valuable money savers. First, you benefit directly through the deductability of the IRA contribution on your federal (and state) tax return. The value of this deduction varies according to your marginal tax bracket. With the majority of field grade officers in the 30-40 percent tax bracket, a $2000 yearly contribution would generate a cut in your tax bill of $600 to $800. Viewed another way, your $2000 contribution actually costs you only $1200 to $1400, since you would have paid the difference to the IRS without this deduction.

Second, the earnings on all the assets in your IRA will accumulate and compound tax-free until you withdraw them. This tax-free compounding gives IRA investments quite a competitive edge. Over long periods of time, these differences add up. We have already seen what a small difference will make in total returns. In the same manner, the accumulation of compounding funds in a tax-free environment makes a difference. If we assume an annual return of 10 percent for a family in the 35 percent tax bracket (most of us equal or exceed this level), the difference between an IRA fund balance and a non-tax-deferred fund balance is staggering. After 20 years, the difference is $80,000 primarily because of the tax-free compounding of the IRA fund earnings. After 30 years based upon the same assumptions, the difference is $262,000. This should remove any doubts over the need for fully funding an IRA yearly.

The dramatic long-term effects of tax-free compounding are clearly demonstrated in other ways. For example, the earlier in the year you make your IRA contribution, the greater your retirement fund will be. After 10 years, the difference between making annual contributions in January vs. waiting until April of the following year will be approximately 24 percent more.

RULES FOR IRA INVESTING

Before examining the types of investment vehicles best suited for IRAs, we should review several rules which govern IRA investing:

Rule 1 - Diversify. Evidence clearly indicates that long-term investors should hold a portfolio of investments differing in type and life (maturity). The easiest way to accomplish this is through well-diversified mutual funds with solid and consistent track records. The majority of mutual fund families have funds designed for retirement accounts as well as a wide range of alternative funds which could be suitable vehicles under certain circumstances. These include growth, small company, bond and short-term money

market funds. Remember that IRAs can be invested into CDs, government securities, individual stocks, annuities, limited partnerships, as well as mutual funds.

Rule 2 - Don't be afraid to trade or switch your IRA accounts. One of the special aspects of the tax shelter inherent in IRAs is that there are no short-term or long-term taxes on capital gains. Therefore, the account can be moved between different investments without a tax implications. This capability not only allows one to adjust to market conditions, but to move to better performing investments.

Rule 3 - You should own some common stocks of both large and smaller company stocks directly or through mutual funds. Smaller companies have greater growth potential than the large industrial giants. Conversely, the larger companies mirror the long-term growth of the American economy. One answer is to invest in mutual funds which have a mix of the two.

Rule 4 - Use bond funds under certain conditions. Over the past three years, 20-40 percent annual returns on bond funds has reversed a pattern of abysmal returns on long-term fixed investments. Prior to this time, the poor performance reflected increasing inflation, driving up rates, but causing a devastating drop in bond prices. A prudent investor doesn't want to get caught with a fixed income investment when increasing inflation is eroding the value of the fixed income. On the other hand, as inflation has subsided over the past three years, bonds have provided an excellent total return. The general rule to follow is: whenever the nominal (market) rate of return on bonds exceed the expected inflation rate by 3 percent or more, bonds should be included in your IRA portfolio. When it appears that inflation is accelerating, particularly above the bond interest rate, IRAs should be shifted out of bond funds and into either money market or growth-income funds.

Rule 5 - The older the investor and the higher his tax bracket, greater should be the emphasis on income funds. The reason is that the older investor has less opportunity to benefit from long-term growth trends in the economy. A 10 percent income return from a bond fund for a senior military officer is more valuable than it would be for a young company or field grade officer. As you approach 50 years of age, and if inflation is under control as it is presently, bonds and bond funds make a lot of economic sense.

Rule 6 - You should shift to lower risk as you approach retirement. This obviously must be adapted to fit the investment temperament and goals of the investor, however as a general rule, the need to preserve what has been accumulated takes on added importance. You certainly do not want to be totally tied up in common stocks, or limited partnerships a few years before retirement, and have the market take a significant and sustained drop. A shift toward intermediate bond funds 4-6 years before final retirement will give you that added protection needed. Some portion, 20-30 percent should remain in well managed, high-quality total return funds. Use as a baseline the return on US Treasury Bonds to measure your investment options.

IRA INVESTMENT CHOICES

Before you can make wise investment choices on where to put your IRA money, you need to understand your alternatives. On the following pages are those alternatives considered to be some of the current "best" choices. Each will be rated on a scale of 1 (low) to 10 (high) on appropriateness for funding an IRA.

ANNUITIES:

Annuities are savings accounts sponsored by life insurance companies and sold by brokers, financial planners, and insurance agents. There are two types of annuities: fixed and variable. The former pays a specific rate of interest, for a specific time, usually one year. After this period, the rate

is set by the underwriting company. Variable annuities pay fluctuating returns because their earnings come from stocks, bonds, and the money market.

Regardless of type, one common feature of annuities are the high fees associated with the product. Some firms charge up to 9 percent, others impose a surrender fee (5-7 percent) plus additional fees to set up the IRA.

Overall rating- 2

BONDS AND MUTUAL BOND FUNDS

Bonds and bond fund will vary greatly in terms of quality of their individual or portfolio holdings. While bonds are currently attractive because of their interest flows, any increase in consumer prices will decrease their value. Additionally, if rates go up, the price of the bonds will decline. Of course if you hold them to maturity, this aspect becomes moot.

The best bond for IRAs are zero-coupons. While just four years old, many of these have been sold for IRA holdings. The zero is purchased at a big discount from face value. Currently, a 30 year Treasury Bond would cost only approximately $65, returning $1,000 at maturity. You don't have to purchase a 30 year bond; maturities of any length can be obtained. Of course their purchase price will be higher, the shorter the maturity.

Overall ratings - 6 (assumed holding until maturity)

CERTIFICATES OF DEPOSIT

More than half of all IRA dollars are invested in CDs. Until recently, the reason was clear: security of principal and predictability of return. Today there are problems with the banking system, however CDs offered through federally insured banks and saving and loans are protected up to $100,000 by various government agencies. While playing it safe is fine, you still incur risk if interest rates rise above the level you've locked in. The longer the maturity of the CD, the greater the impact of interest rate movement on the CD

value.

To obtain the best rates, you'll need to shop around. The highest yields are published in the **Wall Street Journal** each week. Many brokerage houses CDs sell CDs they've purchased from S&Ls. Generally, their rates are the highest. Additionally, they sell without commissions and do not charge early-withdrawal penalties as do banks or S&Ls.

Overall rating - 4 (because of currently low interest rates)

GOVERNMENT ISSUES

These issues come in a variety of forms- Treasury bills, notes, bonds or agency issues. They all work like regular corporate bonds, paying out interest during their life. Because they are safe, they usually yield a percentage point or two less than corporates of comparable maturities. As with corporates, the longer the maturity, the higher the yield. A favorite today are Ginnie Mae Bond Funds, primarily because of the heavy advertisement by investment companies. I suggest you watch what you are buying. Part of the advertised yield is actually a return of your capital because of the level of refinancing occurring today. Strip out this portion, and you find that you are actually down to the CD yield level, a much better buy because the value of CDs are fixed and do not fluctuate as do GNMA fund values.

Overall rating - 3

MONEY-MARKET FUNDS

These funds, operated by insurance, brokerage, and mutual fund companies, invest in short-term debt securities. These yields run three to five percentage points above inflation, generally providing the investor with positive returns on his investment. Safety and reasonable yields are two attributes which make this vehicle attractive to investors. With yields down over that experienced the past 4-6 years, other vehicles are better choices today.

Overall rating - 4

MUTUAL FUNDS

For many, the only place to reach their long-term retirement goals is through mutual funds, especially those that are no-load and a member of a mutual fund "family". When you use a mutual fund to hold your IRA, you are buying shares in a professionally managed, diversified portfolio of securities. Additionally, all of the other attributes we've covered in earlier sections apply- opportunity for growth, easy-to-compare results, a wide range of objectives, investment flexibility, especially with fund families, and a wide range of services.

There are many types of funds, the best ones to consider are those termed: total return, because they not only give you long-term growth, they also pay out a high percentage of dividends. This increases your investment base, permitting the magic of tax-free compounding to work for you.

Generally, account maintenance and start-up fees are $5-15 a year, with the opportunity to move your account to other funds with modest or no additional fees.

Overall rating - 8

REAL ESTATE

The biggest attribute of real estate is the ability to provide long-term protection from inflation. When inflation is high, this is a viable option, however when it is low, as current, there are many other alternatives which have greater growth, with increased liquidity. Any investment in real estate through an IRA precludes borrowing, so all-cash transactions are required, even for limited partnerships. You forfeit depreciation write-offs and other tax deductions that would normally be available if you held real estate outside an IRA.

An additional concern is over the experience of the general partner who

will manage the properties, and the level of fees. All-cash deals should have front-end fees no greater than 10-15 percent of your investment. You should also have a minimum of 7-8 percent cumulative return each year before the general partner gets his share. In today's market, all of this makes real estate a poor investment when compared to other alternatives.

Overall rating - 3

STOCKS

The use of stocks through a self-directed account is ideal for those who have the time, training and temperament to manage them. It is a great way to diversify your retirement holdings. Stocks are liquid, provide inflation protection, and can provide very gratifying returns. A difficulty is in picking the right stocks and correctly timing your buying and selling. Your choice of stocks is as wide and varied as one cares to investigate, ranging from the blue-chip IBM to low priced emerging growth stocks. My advice-know what you are doing before you pick this option.

Overall rating - 5

PAST RESULTS

Results from the past four years indicates that intangible investment vehicles have performed well. The following summarizes selected performances:

Corporate bonds	18.6%
Growth & income mutual funds	17.1%
Treasury bonds	16.6%
Growth-stock mutual funds	14.2%
Certificates of deposit (18 months)	9.8%
Money-market funds	9.1%
Real estate	3.6%

YOUR DECISION

There is no investment available to a military officer with as much potential for providing needed retirement funds than an IRA. Not only is the investment subsidized by the government through an immediate tax-writeoff, the opportunity to make your money grow through tax-free compounding over a period of time is not found elsewhere. The fundamental decision is not if to contribute, but where to do so. This section should have helped answer that question. The opportunity is now yours.

WEALTH BUILDING STRATEGIES

1. IRAs should be funded fully each and ever year, regardless of any other investment program. Borrow the money if necessary(another tax break!).
2. Total return no-load mutual funds should be your first consideration in selecting an investment vehicle. Avoid speculative, non-liquid investments. See the list of mutual funds in the Annex for appropriate suggestions.
3. Manage your IRA in the same fashion as your regular investment accounts-the ... principles apply.
4. ...stand the taxation aspects of IRA distributions and withdrawals.

SECTION XV

PLANNING FOR COLLEGE COSTS

When our generation was preparing for college, the major worry of our parents was whether we would get into college. Today, as parents, we worry not on whether our children will get into college, but on how we are to pay for their education.

For the majority of military officers, there has been an extreme reluctance to adequately prepare for funding education costs. Possibly the belief that sufficient funds would be available. or because of a lack of knowledge, there are very few who started building education funds well in advance of the college years.

The difficulty with this choice is that college cost have doubled in the past ten years and will certainly continue to increase. Traditional student aid programs have not kept pace with inflation and are now earmarked chiefly for students from low income families. Consequently officers are having to either dip into past savings or utilize current after-tax earnings to pay college expenses. All to often, the spouse is forced to work.

There are better options available, all of which preclude the erosion of family wealth or standard of living. As an example, a middle-grade Navy family was able to pre-fund $40,000 for their daughter's education for the total, current cost of $4,100. Think about what you could do with the extra $36,000. This section will show you how to pre-fund your education expenses, and not force you to lower either your standard of living or wealth posture.

WHAT WILL IT COST

Although it's not possible to determine exactly what four years of college will cost in the future, we make approximations.

Over the past 15 years, the annual cost of tuition and required fees at four-year state colleges have surged from just under $300 to over $1,000. At private colleges, the jump has been from $1,300 to $4,750. Room and board figures have been just as dramatic.

It is now estimated that by 1990, assuming an inflation rate of the past 20 years, tuition at public institutions will rise to over $1,500 a year and $8,000 a year at private institutions. Because of federal cutback of student aid and proposed tax law changes, the majority of senior military officers will have to foot the bill given our current high level of income. Unless you have extra funds or plan on seeing your standard of living reduced, the need for early-on financial planning for any education costs is almost mandatory.

Unless your child(ren) plan to attend one of the military academies, or he/she is either a scholar/athlete, you need to consider one of the following ways to fund your child's education costs. All of the plans require the transfer of income producing assets as soon as possible, to the child who is in the lower tax bracket. Some of the proposed plans are quite simple. A custodianship, for example, can be easily set up by the parents themselves. A trust, which requires minor legal work, is only slightly more complicated.

USING THE TAX LAWS

Current tax laws permit a variety of plans which will lead ultimately to a larger college fund, through the reduction in the level of taxes paid by the total family unit. Basically, these plans involve investing money in the child's name rather than a parent's, with tax on the income paid at the lower level of the child's income tax bracket instead of at the higher level of the parent.

If you invested $1,000 at your child's birth, and $1,000 on each birthday until age 17, and assuming an annual return of 8 percent with a marginal tax bracket of 40 percent, the total amount would add up to $28,900. The same

investment in your child's name, because of the tax difference, would amount to $39,250. Even if your tax bracket is lower, the advantage of transferring college funds to your children is very real.

Under Section 2503 (b) of the IRS code, gifts up to $10,000 in value are excluded from gift taxes. Generally any gift to a child who is under 21 years of age at the time of the gift, who would receive or benefit from the property or income before age 21, and who would receive the property and income after attaining age 21, qualifies. The yearly limit of $10,000 is raised to $20,000 if both parents contribute to the gift.

At the present, there is an added imputus to making these transfers. The current Tax Reform Plan being debated by Congress contains some provisions that reduce and even eliminate some of the advantages of these plans. For example, the plan contains a provision to tax the unearned income (interest, dividends, rents, etc) of a dependent child under 14 years of age at the parent's marginal tax rate if the income was earned on property received from a parent. Consequently, it is important to establish any plans before the beginning of 1987 when the bill is expected to take effect.

FINANCIAL PLANNING TECHNIQUES

For those plans which are appropriate for military personal, there are some common characteristics which pertain to income shifting techniques:

- You must put money or other assets in your child's name or in a trust. The earlier you do so, the greater the tax advantage.

- Each plan currently allows income earned outside a trust or distributed by a trust to your child to be taxed at his or her lower rate; additionally, the first $1,080 of the child's annual investment income is tax exempt because the child is eligible for a personal exemption for tax purposes. These earnings do not preclude you claiming him or her as a dependent on your tax

return. Consequently, you actually get a double deduction.

- You can give your child up to $10,000 a year without triggering a gift tax. If married, the annual joint gift limit is $20,000.

- The mechanism you set up to transfer money to your child is irrevocable. This means that once established, you can't change it. If your son, for example, decided not to attend college, he would have control of the money upon reaching majority.

- Custodianships and guardianships terminate when your child reaches the age of majority (18 or 21 depending upon state laws).

- You should ensure that your child's social security number-and not yours- is on any custodian account you have set up.

- There are some costs associated with establishing and maintaining a trust. They vary, however, a legal assistance officer can provide free assistance, at least to get you started.

Let's now look at the various ways to reduce after-tax costs for funding your future education expenses.

FUNDING TECHNIQUES

CUSTODIANSHIP

This is one of the most simplest ways of transferring assets to a child. There is no need for a legal document plus no cost for administering it. In the simplest form, you can open an account in your child's name at a bank, mutual fund, or brokerage house, with you or someone else as the custodian, and then periodically deposit or buy stock as you desire. This form is generally administered under what is called "The Uniform Gift to Minors Act" according to your state's laws. The only possible disadvantage is that the custodianship must terminate when your child reaches majority (18 or 21 according to state law) and all interest and remaining principal then distributed to the child. The biggest advantage is that income from the

investment is taxed at the lower tax rate of the child.

GUARDIANSHIP

This creation operates like a custodianship, however it costs money to administer, and the guardian-you, your wife, or friend-must be approved by a court. You can give your child a gift or a series of gifts over a period of time. These assets are held by the guardian who oversees the investment and the distribution of income according to the state fiduciary laws. Your child's estate will pay for all costs associated with court supervision, accounting, and other fiduciary responsibilities.

Like a custodianship, a guardianship must terminate when your child reaches majority, and the principal and accumulated income distributed to him or her.

OUTRIGHT GIFT

An outright gift is a simple way of shifting money to a lower tax bracket, providing the child is of an age where state laws allow him or her to manage the investment. You should restrict such a gift until your child has reached the legal age at which the state allows these activities. If you make such a gift before this age, it would have to be administered by a custodian, guardian or trustee. The ability to control these funds is limited by law. As mentioned earlier, under certain conditions, a donor (Father, Mother, etc.) is entitled to the $10,000 a year gift tax exclusion.

INTEREST-FREE LOAN

If maintaining control and ownership over education funds is important to you, or if you have other reasons for not wishing to give funds outright to your child, an interest-free loan is a good means of shifting money to a lower tax bracket.

While these have been time honored ways to solve many family related

income transfer problems, both the IRS and the Supreme Court have come down hard on this transfer technique. First, the Supreme Court has recently ruled that interest-free loans result in taxable gifts. The value of the gift is equal to the interest that could be earned with the borrowed funds. Once again the $10,000 per year exclusion applies, generally not creating a problem for the majority of military families.

Second, the IRS treats all interest-free loans over $10,000 as the property of the parent, consequently, any earnings on this amount is taxed to the parent. The exception is if the proceeds of the gift is for non-income producing purposes, such as buying a house, or for directly funding a college education or the borrower's net investment income (interest, dividends, rents, etc.) are less than $1,000.

Consequently, the key numbers for an interest free loan are $10,000 and $1,000: if the sum of all loans (interest free and others) between the lender and borrower is less than $10,000 and the loan proceeds are not directly attributable to the purchase or carrying of income producing assets, no income will be charged to the lender. For loans greater than $10,000 but less than $100,000, the amount of imputed interest to the lender will be limited to the amount of the borrower's net investment income (described above); if the borrower's net investment income is less than $1,000, it is treated as zero, and no income will be imputed to the lender.

CLIFFORD TRUST

For those of you who are not satisfied with other transfer means where the money is permanently out of your control, the Clifford Trust solves that problem. Under other income transfer techniques, should a child not wish to go to college, the money legally belongs to them. By creating a short-term Clifford Trust, the principal will revert to the parents at some time in the future, not earlier than ten years and one day. As in all tax and estate

planning, there are drawbacks such as cost to establish and administer the trust, however you will have the property revert to you after the trust terminates.

A Clifford Trust is useful if:

1. You have assets that you will not need for at least ten years.
2. You can do without the income from the assets for this period of time.
3. You are in a higher tax bracket than your beneficiary.
4. You desire or need the original dollars to be returned to you.

For the Clifford trust to work, it is obviously necessary to establish the trust when your child(ren) are young enough to allow for a minimum of 10 years to elapse before they reach majority. Based upon current IRS rulings, the maximum that can be funded yearly without incurring a gift tax is $16,275 or $32,550 if both parents make the contribution. Smaller contributions can be made or contributions made in subsequent years, however, each contribution must remain in the trust for a minimum period of 10 years and 1 day.

An additional aspect is that to assure a shifting of income to the trust, the person making the contribution to the trust must not have the power to control the use of the trust principal or income or to revoke the trust. If income is in fact used for support of the trust beneficiary whom the grantor (contributor) is legally obligated to support. If these basic rules are followed, the trust or the beneficiary is taxed on any income.

An attorney will be required to draw up the trust as will an accountant to file the required tax returns during the life of the trust.

WHICH TECHNIQUE?

This answer must be personalized based upon your family situation. Your objective regardless of form is clear: pre-fund as much of the future education cost as possible as early as possible, and allow the accumulation of

future earnings in the lowest tax-bracket possible. Under these criteria, the best method for most will be the establishment of a Uniform Gift to Minors Account (UGMA). If you adapt this form, recognize that legally the monies will belong to the child upon their reaching majority age and they have the "legal" right to make use of the funds as they desire. If this causes you problems, then the use of a trust arrangement, such as a Clifford Trust, would be best.

EDUCATION FUNDING OPTIONS

While this sounds redundant, the basic principles of investment apply. Similarily, the keys to investment success need to be at work:

Rate of Return X Time X Money.

Additionally we can make three observations that will affect how and where your invest these dollars:

1. Your education dollar is long term, therefore the investment has time on its side, enabling one to give up a degree of liquidity.
2. Because of the availability of forms which lower the income tax charged on investment income (shifting income to your child), your investment dollar may be spent on assets that earn taxable, ordinary income, i.e. fixed-income investments.
3. Because you are not expected to use the principal or income until the college years, your investment dollar can go to assets chosen for growth potential.

In summary, what you should be looking for are investments which are long-term, taxable, growth oriented, and some-what illiquid.

On this basis, there are several preferred investment vehicles which you should seriously consider:

ZERO-COUPON BONDS

One which has especially recommended for saving for college is the zero-

coupon bond, so named because interest-bearing coupons have already been paid and the value of the investment is in the discounted nature of the bond. These bonds have a maturity of between 10 and 30 years. They pay no annual interest, rather the interest accrues to your account until you sell or the bond reaches maturity. The longer the maturity, the greater the discount, the lower the purchase price and the greater is the growth you receive for your investment dollar.

While no actual dollars are paid out yearly, the build-up of interest is taxed to the owner. This causes us no problem, because the owner should be the child who would not pay any taxes unless he has interest/dividend income of greater than $1,080 in 1986. Remember that the personal exemption is indexed to inflation, so this base amount will also increase yearly. Even if you exceed this level, savings will still accrue to you because of the child's lower marginal tax bracket (10-15% approximately) vs. yours (30-40%).

A zero-coupon bond yields a predictable amount over the life of the bond. If for example, you invest $4,500 at current rates for 17 years, you will receive $30,000. If you invest $4,000 at current rates for 30 years, you will receive $100,000. The key is that you don't have to worry about the reinvestment rate of your interest payments. The zero does this automatically because of its structure. At the same time, the value of a zero fluctuates according to the movement of current interest rates. Unless you need to withdraw the funds prematurely, this will not cause you a problem.

ZERO-COUPON CERTIFICATES (CD)

Recently another form of zero-coupon instrument has been developed, a zero-coupon certificate of deposit insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation. The basic principles apply to this form of zero, only the financial risk is reduced due

to the added insurance of the US Government. You will give up about 1/4 to 1/2 percent annual interest.

For either type of zero's, you should work through one of the major brokerage houses, such as Hutton, Merrill Lynch, etc.

LIFE INSURANCE LOANS

For some, borrowing against cash values from life insurance policies is the preferred method of funding education costs. A universal or variable life policy which creates money-market rates of cash buildup while also insuring the life of either parent is the best form. Borrowing against the policy creates a tax deduction for the interest expense, if in fact the interest is actually paid. Don't fall for the trap of simply adding the annual interest cost back to the policy; the IRS won't accept this this as a tax deduction. Similarily, to make this approach cost effective, you need to insure that you exceed the standard deduction limits for your federal income tax. Currently this level is $3,670, so unless you own a home, it may be hard to break through this ever increasing level.

Because of these reasons, this method is the least economically sound approach, however it still beats paying for education costs with after-tax dollars.

NO-LOAD MUTUAL FUNDS

By now you know that mutual funds provide a sound way to accumulate and protect wealth. Their use to fund future education costs is also appropriate if used in the right way. By choosing funds with high payout of interest dividends, you would be able to accumulate a large amount of future dollars. The same type of funds recommended for funding your IRA could be used for your education requirements, especially when placed in your child's name under an Uniform Gift to Minor Account. Remember, however, that the investment will

have to be monitored to insure that you are earning sufficient income to meet your future requirements.

SERIES EE SAVING BONDS

An bonds purchased should be in the child's name with either parent as beneficiary as oppose to co-owner. To minimize the overall tax bite, a Federal tax return should be filed in the child's name in the first year of purchase. No additional returns are required unless the child's unearned income exceeds the amount of his personal exemption ($1,080 in 1986). No additional tax is incurred when the bonds are subsequently redeemed.

The Series EE bond is sold at a discount, and the interest accrues over time. The yield on a EE bond will vary with market conditions, however if the bond is held for at least five years, the bonds will earn 85 percent of the average yield during the holding period on five-year Treasury bonds, with a minimum yield of 7.5 percent guaranteed. If redeemed earlier, the rate is reduced.

As interest rates continue to decline, one should consider Series EE bonds as possible investment vehicles, given their minimum guaranteed yield, their tax deferral status, and investment safety characteristics.

WEALTH BUILDING STRATEGIES

1. Learn as much as you can about ways to finance your child's education cost. Several excellent booklets describe the various options to include scholarships, grants, and financial-aid ideas. They include:

-**Nearly free Tuition**, Viking Penguin, $15.95 at bookstores.

-**Don't Miss Out**, Octameron Associates, P.O. Box 3437, Alexandria, Va. 22302

-**Early Planning for College Costs**, P.O. Box 467, Rockville, Md. 20850

-**Your Own Financial Aid Factory**, Octameron Press, $7.95 at bookstores.

2. Utilize one of the suggested planning techniques to reduce your overall costs. The key is to reduce the amount of after-tax dollars required to fund

this expense.

3. Seriously consider the investment form of zero-coupon bonds or CDs placed in a Uniform Gift to Minor Account to pre-fund your education costs. Other options will work, however this technique and investment vehicle will provide you with the best and easiest means of reducing your worry, expense, and taxes.

4. Start planning and funding early. Time value of money is on your side if you do so. Don't wait until the child is ready to enter college to become concerned. The opportunity to do something financially smart is now!

SECTION XVI

GOVERNMENT FAMILY PROTECTION PROGRAMS

In addition to your military retirement pay, there are two other plans which should be included into your retirement needs calculations. These are the Survivor Benefit Plan (SBP), and Social Security. We covered the various provisions of SBP along with the death benefits of social security in Section IV. This section will look at SBP from a retirement perspective plus briefly examine social security retirement insurance.

SBP

The question of SBP is entirely different at the time of retirement than during your time on active duty. While on active duty and retirement eligible, you are covered by the Survivor Benefit Plan at no cost to you. At time of retirement, you have to make an irrevocable choice whether or not you continue your SBP coverage. There are many issues which you must consider, the least of which is the cost and related benefits to your family members or other dependents. SBP must be considered as part of your overall estate plan and should be incorporated into the appropriate forms in Section II.

While being one of the best protection programs for survivors, only 74 percent of officers of all services take advantage of the program. There are many reasons for this low participation rate- costs, misinformation, other protection program options, uncertainty over the need and benefits, etc. As a result, many have difficulty deciding between SBP and other protection plans. This confusion will probably continue as changes continue to be introduced by Congress.

COST AND BENEFITS

The SBP annuity is equal to 55 percent of the base amount selected by the retiree. The cost of the SBP coverage is computed on the base amount by the

formula: .025 times the minimum base of $300 plus .10 times the remainder of the selected base amount. The cost is deducted monthly from the member's retired pay and is exempt from federal income taxation. They may also be deductible from state income tax.

With the passage of legislation in 1985, the election of less than the maximum base amount must receive the concurrence in writing of the spouse for those whose retirement date is on or after 1 March 1986. If there is no concurrence, the member will be automatically enrolled in SBP. Other provisions exists for former spouses, or retirees without a spouse but children or persons with insurable interest.

Until this year (1986), both the cost and benefits of the SBP were adjusted for inflation. This year, the Balanced Budget Act, the Gramm-Rudman-Hollings Act, temporarily zeroed out the annual adjustment (COLA) for a period of 5 years. Whether this provision will remain is problematic, given the Constitutional challenge to the act, a heavy lobby by military -related organizations, and concern by some Congressmen over the fairness of the issue. The difficulty this provision creates is that the strongest attribute of the SBP over other options was the ability of the plan to maintain its purchasing power.

Another key advantage to the SBP is that it is a tax exempt program, with the amount paid in excluded from taxable income. On the other hand, the proceeds paid to a spouse are taxable, while those of other options are not necessarily taxable due to the availability of tax-free investment opportunities. Still another key element is the social security offset whereby SBP payments to a surviving spouse are either offset directly by an amount based on the retirees military earned wage credits or, under a new rule, have the payout reduced to 35 percent of the base at age 62. For those

still on active duty, your spouse will receive the highest level of payout from the two methods.

FACTORS TO CONSIDER IN MAKING CHOICE

In making the choice at retirement, there are a series of factors which will influence your decision. The decision, by design, is one based upon your personal situation which may go beyond these factors. At the least, these should be part of your decision-making process.

First, your current financial situation should be considered. If you have considerable assets accumulated at the time of retirement and have pre-funded future requirements such as education costs, you may have provided sufficiently for your family members. On this basis alone, it may be feasible to select the minimum SBP base only ($300), and supplement any extra funding through term or universal life insurance. On the other hand, if you have done nothing to provide for family protection after your retirement, the maximum SBP base would be an appropriate consideration.

Second, the ages of you and your family members must be considered. As expected, costs for alternative plans such as term or universal life will be higher for older persons. Other factors include higher taxes because of a higher retired pay base from additional years on active duty. At the same time, higher SBP costs and a shorter life expectancy for the older spouse makes a combination of the minimum SBP base plus term or universal life a very viable option.

Third, the health condition of you and your spouse should be considered from the standpoint of whether she would continue to draw SBP after your death for a sufficient period to recoup your payments. This is obviously a very difficult question. The point is that if you live a long life, your wife may not live long after you. On the other hand, if your wife decides to remarry before age 60, the SBP annuity will be terminated. If she is older than age

60 and then remarries, the annuity continues uninterrupted.

Fourth, the age and health of your children should be considered. The cost of including your children in any SBP base is only .03 percent. If both you and your spouse were to die, SBP would be paid to the child until they marry or reach age 18 (22 if attending school full-time), which ever occurs earlier. If the child is physically (or mentally) incapable of self-support and the condition existed before age 18, the child would receive SBP payments indefinitely.

Fifth, the cost and benefits of SBP vs the cost of other options should be considered from a tax standpoint. Your gross taxable retired pay is reduced by the cost of SBP, consequently you are in essence paying for SBP with before tax dollars. Other alternatives use after-tax dollars, making them, \$ for \$, more expensive. This relationship reverses itself for the benefit payout. SBP annuities are taxable as ordinary income to the recipient, whereas life insurance proceeds are not. Additionally, live insurance proceeds can be, and should be, received in a lump-sum up to the total policy level, whereas SBP payments are received monthly and only while the spouse (or child) is either living or eligible for the payments.

Sixth, future benefits and their purchasing power must be considered. Until this year, SBP was inflation protected, one of the key selling points of the plan. The government was, in fact, subsidizing the cost and benefit of the plan. In essence, the cost of the plan did not increase from the day of retirement while the benefit subsidy created an increasing term policy for the spouse. This feature has changed with the passage of the Gramm-Rudman-Hollings Act of 1985, whereby the COLA adjustment has been suspended until 1991. According to industry experts, the impact on a current retirees spouse will be approximately 15 percent on total benefits. For those currently on

active duty, there is no impact because active duty pay continues to increase yearly, driving up future pay from which the SBP base will be computed. There are very few commercial products which have an inflation kicker, and those which do require additional payments.

WHICH IS BETTER CHOICE?

A very difficult question which needs to be analyzed with the assistance of professional from military-oriented life insurance companies such as Army Mutual Aid, Navy Aid or The Retired Officers Association. As a starter, The Retired Officers Association produces an excellent booklet on SBP, **SBP MADE EASY**, obtainable from the Association, 201 N. Washington St. Alexandria, Va. 22314-2529.

The key point one should keep in mind is that the day one retires, financial protection for their family has been reduced by the future value of SBP if the service member "elects out′ of the program. To do so necessitates that other family protection programs have been established, otherwise, you are placing your spouse′s and other family members future in financial jeopody. Currently for an O-6, with 26 years of active service, the amount one forgoes is approximately $325,000.

For general guidance, it is suggest that, under any circumstances, the minimum amount of SBP (currently $300) should be selected and that any eligible children should be covered. Under any set of criteria, the minimum SBP base will provide the maximum protection at the least cost. For coverage above the minimum, your personal and financial situation should be reviewed by one of the military-oriented life insurance companies suggested earlier.

SOCIAL SECURITY RETIREMENT INSURANCE

Eligibility for Social Security benefits is based on wage credits earned by paying FICA taxes. Military members have been paying FICA taxes since 1956. The benefits to a military officer who dies on active duty have been

covered in Section IV. The benefit to an officer who lives at least to age 62 is that he or she becomes eligible to fully retire and receive a monthly benefit for life. In some cases, spouse and children may also be eligible for Social Security benefits.

The monthly payments you and your family will receive will depend on your "basic benefit", which is in turn dependent on the average of your monthly earnings over most of your working life. In Section IV, these aspects and definitions were explained and demonstrated. As indicated, it is difficult to do more than estimate what your future benefits would be. Also complicating this picture is the question of what Congress will do to Social Security before your retire, and what choices you have in determining when you and/or your spouse can start drawing Social Security retirement benefits.

To help in answering the question of what will be our future Social Security retirement benefits, we can use as a starting figure, the maximum 1986 benefit of $756 a month. We have already worked through these figures in Section IV, so the valuation figures are available to include in the appropriate forms in Part II.

TAXATION AND EARNING LIMITATIONS

The 1983 Social Security law, effective with 1984 income tax reporting, created a tax on part of Social Security benefits. While the formulas is complicated, suffice to say that one-half of Social Security benefits will be taxed as ordinary income if your adjusted gross income (including tax-free income) is greater than $32,000 and you file jointly. Remember that age 62 (or 65) is a long way off for most of us, however, you should be aware that this backdoor taxation practice exists today and probably won't go away.

Similarily, Social Security recipients under age 70 lose a portion of their benefits if their other earnings are to high. For 1986, those under age

65 may earn up to $5,760 without giving up $1 for every $2 of earnings. For those 65 through 69, the limit is $7,800. Those over 70 may earn any amount without reduction of their social security benefits. Again, this aspect is a long way off for many, however, you should know of its current existence in our laws.

WHAT SHOULD BE DONE NOW

The only requirement that one should accomplish while on active duty is to ensure that the correct amount of wage credits are being applied to their Social Security account. This is important in that current laws sets a time limit of three years, three months, and 15 days after the year in which the wages were paid for correction of mistakes. After this time, it is next to impossible to correct a mistake. The way to check is to send a short letter to the Social Security Administration, P.O. Box 57, Baltimore, Md. 21203 requesting a statement of social security earnings and quarters of coverage. This statement can be verified from your leave and earning statements or your W-2 tax forms. If errors are found, have your supporting finance officer resolve the problem.

WEALTH BUILDING STRATEGIES

1. Ensure that you understand fully the financial impact of declining all or part of the SBP on your spouse and family.
2. Regardless of your election of coverage under SBP, always option for the minimum base coverage ($300 in 1986) plus coverage for any eligible children.
3. Do not make the election decision along. Contact the experts at organizations such as Army Mutual Aid, Navy Aid, and The Retired Officers Ass.
4. Incorporate the maximum Social Security retirement benefit ($756 for 1986) into your retirement needs calculations in Part II. Remember that benefits do not start until age 62 at the earliest unless you die before that age.

SECTION XVII

ESTATE PLANNING

Estate planning can be defined as arranging for the transfer of your property to others in such as way to achieve your objectives for your family and possibly others. The planning process incorporates your efforts to create and protect assets over your lifetime as well as provide for the orderly and timely disposition of these assets during your lifetime and at death.

For many officers, effective estate planning may amount to the preparation of a simple will and review of the beneficiary provisions of life insurance policies (including SGLI/VGLI) or for a few, it could involve complex trust or estate procedures. In all cases, tax minimization is an important motivator for effective planning.

OBJECTIVES OF ESTATE PLANNING

It is doubtful that many officers have really given estate planning a hard look. Yet, we have accumulated a number of assets which should be distributed according to our wishes. Unfortunately, unless we take some active steps, this may not occur.

Many of us labor under the belief that our surviving spouse will automatically inherit our estate when we die. This is not true in many states if you do not have a will. A surviving spouse, assuming their are dependent children, will inherit only the percentage of the estate which the local law permits. The surviving children will receive the remainder in equal shares. In some states, if no children exist, parents, brothers and sisters share with the surviving spouse. It gets even more complicated where there has been remarriage, divorces without remarrying, etc. It is also complicated if you are a resident of one of the five community property states. If nothing else is retained from this section, it should be: **EVERYONE NEEDS A WILL.**

To help understand what you are really trying to accomplish through estate planning, let's review a number of specific estate planning objectives which may apply to you and which will help get you started in this very important area:

1. Determine who are your heirs or beneficiaries and how much do you want each to receive.

2. Develop sufficient plans to provide adequate financial support for your dependents? You should be able to answer yes if you have put the wealth building strategies to work.

3. Structured your estate in such a way that you hold estate transfer cost to a minimum. You should know that there are many different tax and expense requirements associated with a poorly developed and executed estate plan. The same applies even worse when there isn't any plan.

4. Provide sufficient liquid assets for the estate to meet its obligations. The need will arise regardless of size of the estate.

5. Decide who will settle your estate and how any property is to be administered.

6. Plan on how the estate's property is to be distributed. You can do this while living and/or at your death.

WHAT IS YOUR ESTATE

While this sounds like a simple question, yet there are several answers, all of which may not be the same.

First, a person's **"probate estate"** is the property that is handled and distributed by one's executor (if there is a will) or administrator (if no will is present). Generally it is property that one owns outright in his own name, his interest in property held as a tenant in common with others or life insurance payable to one's estate upon death. This property will pass through probate according to the terms of your will or state laws if there isn't a

will. As will be seen later, the final distribution under these two processes are very different.

A second definition is **"Gross estate for federal estate tax purposes"**. The gross estate is defined by tax law and is the starting point for calculating how much federal estate tax the estate has to pay. It includes, the property in the probate estate, life insurance owned by the estate owner on his or her own life, the portion of jointly owned property representing the decedent's partial interest (if held jointly with one's spouse, only one-half of the value of the property is included), annuities and death benefits (such as SBP), and reversionary property rights (such as property held in a Clifford Trust).

Under the Economic Recovery Act of 1981, an unified credit was provided to each individual at the time of his/her death. This credit has virtually eliminated the payment of any federal estate taxes except for only a small number of very wealth individuals. In this year, the unified credit exempts $500,000 of one's federal estate. In 1987 and later, this amount increases to $600,000. Consequently with a little effort, a husband and wife can exempt up to $1,200,000 beginning in 1987.

The third definition is **"Net"** estate. This is what most people are concerned over-what will be available to support the family. This estate consists of the assets going to one's heirs and beneficiaries after the payment of the costs of dying (debts, claims, administration expenses, etc.).

CREATING AN ESTATE PLAN

To create a solid estate plan, there are four basic means: wills, trusts, lifetime gifts, and joint ownership. The cornerstone of most plans for military officers is that of a will. It is recognized as the primal disposition document of his estate.

WILLS

There are several important reasons why everyone, officer as well as spouse, should have a completed will. These reasons include:

1. The ability to transfer property to specific heirs and beneficiaries according to one's own plan. If you do not have a written will, estate property will be distributed according to state laws. As mentioned earlier, there is a wide variance among states in how this process is carried out. The important thing to understand is that, in many states, you spouse may not receive all of your property if you have children. Depending upon your circumstances and state laws, others could possibly share in your assets regardless of your desires. By creating a will, you are able to formulate and implement your own plan for distribution of your assets.

2. To name guardians for minor children. For a military officer, the primary reason for having a will may be to accomplish this. It becomes valuable in situations involving a common accident where children are left without a parent. In addition to naming a willing person, provisions need to be made, either in the will or through some other device such as a trust, the means to support any children.

3. To prescribe how heirs or beneficiaries are to bear taxes and expenses. State laws allows for the determination in wills as to the means of paying taxes and expenses. If not cited, state law will provide the answer, not always in your favor.

4. To exercise discretion in giving of certain properties. If you desire to leave specific property to certain individuals, a will can accomplish this.

5. Protection against double death taxes. Through careful planning, a will can prevent the same property from being taxed twice when both family members have died. A will allows for one to take advantage of the unified credit mentioned earlier ($500,000 exemption per person in 1986). Upon death, the

exempted property passes to the heir or beneficiary for their lifetime use.

6. A will provides for one to leave specific instructions on various matters. Instructions may include information on burial procedures, identify who owns what property, and state one's correct domicile for probate purposes.

7. Allows for planning in case of a common disaster. A will permits one to provide for contingency planning in case of such a disaster, and to preclude unwanted distribution of one's assets.

8. A will facilitates the implementation of other estate planning documents such as testamentary trusts or powers of appointment (permits the disposition of estate property by someone designated by the deceased).

9. A will establishes the right to select an executor. The appointment of the executor or administrator, if no written will, is an important matter, and one in which the writing of a will identifies the chosen personal representative of the deceased. Otherwise, state law permits the courts to appoint one.

10. To avoid probate. There are many reasons why one would want to avoid probate. First, there could be delays in settling the estate and getting the assets to your beneficiaries. Second, the administration fees can take a substantial piece of the estate. Third, creditors and others can sue to contest a will or probate action in an attempt to get at the estate property.

As a minimum, each military officer and their spouse should visit their Judge Advocate General office to discuss estate planning and have an appropriate will drawn up. If other, more complex planning is required, the legal assistance officer can either develop these plans, or refer you to an attorney who can.

TRUSTS

A trust is a fiduciary arrangement set up by someone which allows transfer of property to one individual to be held by him for the benefit of another. By definition, there are three parties to a trust: someone who sets up the trust, called a creator or grantor; someone or something who holds legal title to the property, called a trustee; and someone who will benefit from the trust, called a beneficiary.

There are two primary objectives for establishing trusts: tax savings and control over assets after ones' death. Depending upon your desires, there are a number of trust forms which can accomplish both of these. Two of the most relevant ones for military officers are the living (inter vivos) and trust under will (testamentary). A living trust is a personal trust created by an individual during his lifetime to benefit either himself or someone else. A trust under will is a personal trust created by a person's will that, like the will, does not become effective until after the person's death.

Living trust can be divided into two types: revocable or irrevocable. A revocable living trust is one where the creator retains the right to revoke or amend the trust during his lifetime. An irrevocable living trust precludes the creator from revoking or making changes to the trust at any time.

If structured correctly, the living trust can save both estate and income taxes, control your property during your life, puts property into hands of qualified managers, keeps assets in trust until your children reach a certain age, provides for college educations, and if required, provides for care of sick or elderly parents.

The testamentary trust also accomplishes much of the above, the only difference is that it becomes operative after your death. One of the best ways to hold your child(ren) inheritance is through this form of trust. If

you name a guardian of your children's property through your will, the court will require annual reports of major expenditures and investments on the children's behalf. If you have chosen the guardian well, this process is unnecessary.

A trust also keeps a child's inheritance out of his reach for as long as you desire. Under a guardianship, they would gain control over the assets at the age of majority, usually 18.

Regardless of the type or reason for establishing trust, the one principal rule which applies is to consult with qualified estate attorneys. The starting point is at your legal assistance office .

LIFETIME GIFTS

One of the easiest ways to reduce your estate while providing assistance to others is through gifting. For the average military officer, the role of gifting is probably more connected with "caring and assisting others' than for estate planning purposes. At the same time, you should understand the basic rules under current laws; opportunities for gifting of your children's education costs, for example, could backfire if not executed properly.

The biggest charge to the laws is that now one can give up to $10,000 a year to anyone without incurring a gift tax. Additionally, gifts between spouses are no longer limited, nor are gifts made in contemplation of death- those made within three years of the donor's death. The above applies to all but gifts cf life insurance policies.

If one does decide to participate in a gift giving program, certain assets are especially suitable from a tax standpoint, especially if given to family members. As we saw in the section cn funding of education expenses, gifts of income-producing property to a family member in a lower income tax bracket can be beneficial not only for pre-funding the education cost, but in reducing the total income taxes payable by the family unit.

Before one initiates any major gifting program, it is advisable to check with competent tax and estate authorities. Currently, the Congress has included language into the Tax Reform bill which could cause earnings on certain gifts to family members to be taxed on the parent. Second, state laws do not always follow federal gifting laws. This is especially true for community property states.

JOINT OWNERSHIP

One of the traditional ways for husbands and wives to hold property is through a form of plural ownership. This form is generally satisfactory for assets such as one's home especially when the surviving spouse is likely to continue to use the property. In a few cases, joint ownership either causes problems or forces either the surviving spouse or the deceased's estate to pay taxes which could be avoided.

The advantages and disadvantages of joint ownership are easily described. The advantages are:

-avoids probate

-ease of transfer of title to survivor

-both spouses have easy access to assets

-psychological/emotional comfort of sharing

The disadvantages are:

-loss of asset control as partners must act jointly

-sharing of any appreciation or income

-co-owner consent to dispose or change condition of asset

-potential management and control problem for survivor

-legal uncertainties if marital problems occur

There are two primal reasons why a family would want to sever joint ownership of their assets. First, if they have together a very large estate.

Even today with the changes of the Economic Recovery Act of 1981, one may, over his lifetime, accumulate an estate which exceeds the unified gift and estate tax credit. In this year, the credit shielded $500,000 from gift and estate taxes. If the total estate of husband and wife was held jointly and exceeded this amount, a tax would be due upon the death of the second family member unless they reduced their estate below the unified credit level.

The way to handle this problem is to untie some of the jointly owned property so that each would own property in their own names. Properly done, a couple could shield up to $1,000,000 in 1986 and $1,200,000 in 1987 and thereafter. While these look to be extraordinary large, over the years, even military officers can accumulate estates of significant amounts.

The second reason pertains to income tax laws. Prior to 1982, if the first spouse to die made the entire contribution to a joint holding, all of its value would be included in his estate with the holdings in the hands of the surviving spouse receiving a "stepped-up" (adjusted to market price) for capital gains purposes.

Under current laws, only one half of any such holdings-regardless of who purchased the asset-is included in the estate of the first spouse to die, and only that half receiving a stepped-up basis. For this reason, it makes sense to consider the placing of certain assets with high appreciation in the name of one of the spouses so that the entire amount can be given a stepped-up basis for income tax purposes. This change will reduce the capital gains tax charged to the surviving spouse when she sells the asset. Appropriate assets include real estate, stocks, bonds, and mutual funds.

THE STATE TAX BITE

Even though we may not be faced with federal estate or gift taxes, the odds are that you or your heirs will be faced with state gift, estate or inheritance taxes. In fact, 29 states and the District of Columbia levy some

form of inheritance or death taxes. The laws in each state varies tremendously in who and what they tax.

Another implication is that our mobility permits us to accumulate a variety of assets, such as real estate, which remains behind when we move on due to PCS. When we die, our estate faces the possibility that it will not only be taxed by our state of residence, but also states in which we hold property. If we have large holdings in states other than where we maintain our legal residence, provisions should be made, either by will or through some other device, to fund these added state taxes. Again, the first place to check is your legal assistance officer.

WEALTH BUILDING STRATEGIES

1. Make a will for yourself and your spouse. Don't take a chance and not have one. You penalize yourself and family.
2. Use a qualified lawyer to draw up your wills.
3. Update your wills as circumstances change, such as moving to another state.
4. Provide for flexibility in your will and any trust arrangements.
5. Ensure that you understand the purpose and tools for estate planning. Plan so that your family are not financially deprived if something happens to you.
6. Consider the use of trust, gifting, and joint ownership techniques if they apply to your personal situation. As a minimum, have an up-to-date will on file for yourself and spouse.

SECTION XVIII

TAX PLANNING

Understanding the tax laws and how these laws apply to your specific financial situation is your key to saving tax dollars and obtaining greater economic growth. Many of us in the military are unsure about using techniques which would reduce our taxes. Our professional service to this great country should not blind us to financial realities- rather we should recognize that Congress has, in fact, provided us with a special set of tax laws designed to compensate us for service to our country. We do no wrong by utilizing what Congress has proved us.

What then is tax planning? It is nothing more than a plan which allows us to understand the opportunities that exist to legally reduce our income tax bills. The benefit to you and your family is money not spent on an one-way trip to Washington each April. Increased spendable income, greater net worth, conservation of hard earned dollars, and more capital for saving and investments are your benefits.

While the tax laws apply to everyone with taxable income, tax planning differs from person to person. As you review the following recommendations, ascertain if the recommendation applies to you and if so, study the tax laws so that you can apply the saving to your next years' return. The time to start is NOW...

PLANNING TECHNIQUES

There are five basic ways to legally reduce income taxes: convert, exclude, deduct, defer, or shift. Examples are:

1. Convert- This means to convert ordinary income to more favorable taxed long-term capital gains. For example, one could hold a capital asset (stocks, bonds, mutual funds, etc.) for more than six months and received preferred

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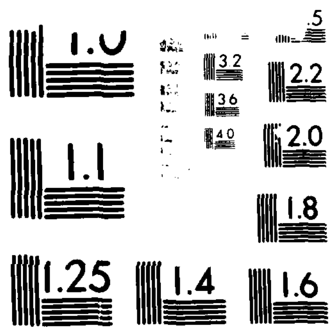
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long-term capital gains tax treatment when the asset is sold.

2. Exclude- This means to select assets which produce income which is excluded from taxation, such as municipal bonds.

3. Deduct- This means to deduct all allowable business and personal expenses from gross income in order to reduce the taxable base against which the tax rates are applied. Examples would be IRAs, moving expenses, and charitable contributions.

4. Defer- This means to defer the payment of tax by either delaying the receipt of income, or by accelerating the payment of deductible expenses. For example, paying of next year's property tax due in January in December of this year. No one should pass up the opportunity to defer taxes on at least $2,000 a year through an IRA.

5. Shift- This means that a taxpayer shifts or diverts income away from himself to another taxpayer entity, often a person such as a son who is in a lower income tax bracket. For example, a father gives monies to a son to invest for later college expenses. Any taxes would be charged to the son instead of the father, thereby shifting the tax to a lower income tax bracket.

By examining particular techniques, one can see how these general planning principles apply. In some cases, like gifting of appreciated property to lower income individuals, one is able to take advantage of a combination of these techniques. Here, gifted property is not taxed to the recipient upon receipt; any income is shifted to the recipient's lower tax bracket, and even if there was a recapture requirement on the property (a rental property with accelerated depreciation), through the gift, this ordinary income requirement would be converted to capital gains with a much preferred tax rate.

WHERE AND HOW TAXES ARE SAVED

A question which we ask often but do not follow through on is, "How can I save on my income taxes?" The answer is by knowing how various types of income are taxed and what tax-planning technique(s) from the discussion above can be used to reduce your taxes, then taking the appropriate action.

In spite of efforts to change the US tax system, there will always be certain economic incentives provided by the government through taxation. Some income will be tax-free; some given tax-favored treatment; some will be tax-deferred; and some will be offset by non-cash deductions such as depreciation on real estate.

Let's tie together these concepts for saving of taxes by identifying ways to put these techniques into play:

TAX-FAVORED INCOME

Any investment income that qualifies for long-term capital gain treatment is tax-favored. Currently one is able to convert ordinary income to long-term capital gains by holding the capital asset for more than six month. For tax purposes, only 40 percent of any realized capital gain will be included in your income. The other 60 percent is excluded.

One of the many advantages of mutual funds is their tax treatment. Because mutual funds are considered "regulated investment companies", they can avoid paying any taxes on their investment income and capital gains by distributing at least 90 percent of all such profits to their shareholders. A smart investor can determine when a fund is to pay these distributions and use this knowledge to his advantage. If the distribution is scheduled to take place soon, delay the purchase until after the distribution. Otherwise if you invest today and the fund pays a distribution tomorrow, you owe tax on the amount of distribution. In essence, the distribution is a return of your

capital because the share price drops by the amount of the per share distribution.

If contemplating the sale of a fund's shares, you want to do so before the distribution, otherwise you have to pay the tax on it. Another reason for doing so is because of a change in the IRS Code in 1984 which states that any loss realized from a mutual fund holding of six months or less is a long-term capital loss to the extent of any long-term capital gain distribution received during the holding period. Remember that the share value drops by the amount of the per share distribution, and that long-term capital losses are deducted on the basis of $1 for every $2.

TAX-EXCLUDED INCOME

For tax purposes, your tax-free income is entirely excluded from your income. Tax-free income falls into several categories:

-Taxable dividends received on stock or mutual funds- $200 for married couples, $100 for single persons.

-Interest on municipal bonds or bond funds.

-Up to $125,000 of the gain on the sale of your personal residence if you or your spouse is 55 years or older prior to sale and you have owned and used the house as your principle residence for at least three of the five years preceding the sale.

-Any amount you receive through gifts or inheritances.

-Proceeds from a life insurance policy of which you are the designated beneficiary. Borrowings from an universal life policy up to the amount of paid-in premiums are also tax-free.

-Some or all of the Social Security benefits based upon your total adjusted income.

TAX-DEFERRED INCOME

In some cases, income from some investments is tax-free for a specific period of time, and is therefore known as tax-deferred. The value to one is found in the compounding of interest without the negative impact of taxation. As we have seen the increase can be at a relatively rapid rate.

The most widely known type of tax-deferred income is the IRA. An IRA really has two advantages- the contribution is deducted from taxable income and it accumulates and compounds tax-free. It becomes taxable only when withdrawn in later years.

The importance to you of making this contribution and attempting to obtain the highest annual amount of earnings within a constrained risk environment again warrants the following spreadsheet:

Annual Contributions of $2,000

Years in Plan	Total Deposits	Principal and Interest Earnings		
		8%	10%	12%
10	$20,000	$28,970	$31,870	$35,100
20	$40,000	$91,520	$114,550	$144,100
30	$60,000	$226,570	$328,990	$482,670

Again, notice the large difference that result from both the rate of return as well as the added time. Remember the formula: **Rate of Return X Time X Money**

Another good example is your personal residence. Any time you sell a residence and reinvest the proceeds in another personal residence within 48 months before or after the sale of the old one and the purchase price of the new residence was greater than the adjusted selling price of the old house, you can defer the gain on the sale.

If you invest in mutual funds (as you should), one easy way to defer paying capital gains is to delay selling just before year end. If you do,

then taxes are due not later than 15 April. By delaying until January, any taxes owed are deferred until 15 April of the following year, up to 15 months later. On the other hand, reverse the process if you would have a capital loss if you sold in December, as the loss would be deductible on the tax return filed not later than 15 April.

TAX-DEDUCTIBLE EXPENSES

There are numerous expenses which can be deducted to off-set taxable income. These can range from your standard type deductions- medical, taxes, interest, charitable contributions and casualty losses-to unique types such as alimony, moving expenses, IRA contributions, miscellaneous expenses such as tax and investment advice, rental of safe deposit boxes, military insignia, and professional journals. There are obviously many others. The planning implication is that you need to either know them or have a good tax person who understands taxation of military personnel.

TAX-SHIFTING

In our previous section on funding of future asset requirements, education costs and estate planning, we discussed in detail the various planning techniques available to shift heavy taxed income into lower brackets. This material should be reviewed along with that in this section to insure that you take advantage of any opportunities which would fill your needs.

THE IMPACT OF THE COMING TAX REFORM ACT

Probably the most hazy question is if and when the Congress will finalize the tax reform act. While there has been starts and stops ever since the original bill was introduced, the odds are that something will materialize either this year or in 1987. Another question is what will the final act look like, another mystic question. Given the structure of what has evolved to date, the following areas have become clear:

-INDIVIDUAL TAX RATES. All options will reduce individual tax rates. The best guess is that the top rate will drop from 50 % to 35-38%, with others dropping proportionately. Senior military officers can look for marginal tax rates of between 20-28%.

-TAX PREFERENCES. The deduction for state and local taxes will likely be scaled back versus being totally eliminated. The scare over deductability of interest on homes has subsided, with this preference being retained.

-TAX DEFERRAL PLANS. The IRA will probable remain as is. Probably being dropped will be the benefits of trusts such as the Clifford trust, which enables parents to cut their taxes by shifting income to their lower tax-bracketed children.

-CAPITAL GAINS. The top rate will probably remain at 20% as opposed to Reagan's proposal to cut them to 17.5%. The advantages of capital gains will remain even if the rates are adjusted.

-REAL ESTATE. One of the hardest hit investment areas will be real estate. Depreciation will be slowed by extending the depreciation period and the at-risk rules will be extended to this area, both actions reducing the amount of tax write-offs.

-LEASING DEALS. The elimination of the 10% investment tax credit and slower depreciation will reduce the attractiveness of this area as a tax shelter.

-TAX-EXEMPT BONDS. Congress will restrict the tax exemption for income from certain state and local bonds, by identifying what type bonds are municipal and which are not. This reduction in offerings will help make tax-free bonds and mutual funds even more attractive, assuming interest rates do not move back up.

TAX-SAVING TIPS

--The best tax guide is free from the IRS-Pub. 17. Order it from your regional IRS office.

--If you or your spouse are overseas on 15 April of any year, you receive an automatic two-month filing extension. If more time is required, file Form 4868 for an additional four month extension. You must pay interest on any tax due.

--IRS provides copies of old returns for $4.25 each.

--Single filers should itemize when their deductions exceed $2,480.

--Married persons who file jointly should itemize when their deductions exceed $3,670.

--Itemized deductions include expenses for:medical and dental care, interest payments, state and local taxes, charitable contributions, casualty and theft losses, and job and investment costs. You can deduct military uniform accessories, cap ornaments, rank, expenses for alterations for promotions, uniforms if not acceptable to be worn off-post.

--If your spouse works, you can deduct 10 percent of the lower-paid spouse's earned income-up to $3,000.

--If you obtained surges or steep rises in your total taxable income, you may qualify for income averaging. Use Schedule G.

--If you pay someone to care for a child or some other dependent while you are at work, you may qualify for a tax credit of up to $720.

--Even if you do not itemize, you can deduct one-half of charitable contributions made in 1985; 100% in 1986.

--If you donated to charity more than $500. in furniture, clothing, or other non-cash items you must file a new IRS form-8283.

--You can contribute to a 1985 Individual Retirement Account (IRA) until 15 April of each year. No extensions are permitted.

--You can contribute up to $2,000. of your earnings to an IRA and twice that if your spouse works. Married persons-when only one spouse works - can

contribute up to $2,250.

--Custodial fees for IRA's are deductible if paid separately from the contribution, i.e., with a separate check.

--You can deduct 21 cents a mile for the first 15,000 miles of business driving. This included local travel for military personal if documented.

--The first $100($200 if joint return) of qualified dividends are not taxed.

--You pay no state or local taxes on interest from Treasury Bills, US Saving Bonds or other US Government obligations.

--You can deduct the cost of a safe deposit box used to store investment-related documents.

--You can deduct transportation costs for inspection trips to your investment property.

--To obtain favorable long-term capital gains treatment on an investment purchased on or before 22 June, 1984, the investment must have been held for more than a year. For investments made after 22 June, 1984, the holding period is only six months.

--To avoid double taxation, ensure that the amount of reinvested distributions from mutual funds are added to the original cost basis. This increases your cost basis for when you later sell the shares.

--Tax indexing went into effect during the 1985 tax year. Tax brackets, zero bracket amounts, and exemptions are now adjusted for inflation. (3.7% in 1986.)

--You can deduct casualty and theft losses(including HHG) that exceed 10 percent of your adjusted gross income.

--Losses on sales of mutual fund shares held for less than six months will be treated as long-term capital losses to the extent of any long-term capital gains dividends paid from the fund during the holding period.

--Points paid by the buyer of a house are tax deductible, but not loan

orientation fees unless they are actually for use of mortgage money and not for services. The following are added to the basis of the house, reducing the possible gain when you do sell later: mortgage origination fees for services rendered, broker's commission, title search, title insurance, recording of deed, attorney's fees, survey and appraisal fees. A seller can also add these expenses, if paid, to the basis on any new house purchased. Many of these expenses will also qualify as moving expenses if you are PCSing. See Form 3903.

--If you received a tax refund which exceeded 10% of your total taxes payable, you should increase the number of exemptions on your W-4 form. Follow the instructions on the new form or see your supporting finance officer.

--If you are selling an investment which will create large taxable gains, consider either an installment sale or the use of an escrow account. Either of these techniques, if properly constructed, will spread your gain over two or more years, minimizing the amount of total taxes paid.

--Military personal can defer any gains from the sale of their principal residence for a total of four years. If you sold your residence after 18 July, 1984, the replacement period is suspended while you are stationed outside the US or while you are required to live in on-base quarters after you return from overseas. The total period cannot exceed an eight year period.

--When calculating your moving expenses on Form 3903, you should reduce your expenses by the amount of Dislocation Living Allowances(DLA) paid to you.

--You can deduct the cost of temporary living quarters (food and quarters)after arriving at your new assignment location up to a 30-day period. Use Form 3903.

--When you pay a deductible expense with a credit card, deduct the expense in the year you made the charge, not the year it was paid. Use Schedule A, Form

1040.

--You should add sales taxes on any big purchases to the sales tax tables to estimate your sales tax deduction. Use your total income, including any BAQ, BAS, and VHA to determine this deduction.

--Use the following rules to minimize your taxes on investment sales:

-If have long-term gains, do not generate short-term gains or loses.

-If have long-term losses, use most advantageously against short-term gains; minimize long-term gains in same year.

-If short term gains, offset against long-term losses.

-If short term loss, use against other ordinary income. Minimize long-term capital gains.

--Generally, income with "pay" in the title is taxable; income with "allowance" is not taxed.

--Report as interest, "dividends" received from credit unions, saving and loans, and bank CDs´. Interest from Money Market Funds are treated as dividends on Schedule B.

--If you purchase Series EE/H bonds for your children, ensure you register the bonds in the child´s name, otherwise the purchaser is taxed on the interest.

--Dividends from insurance companies, such as USAA, etc. are not taxed as dividends, rather as a reduction of the premium.

--If you sell a capital asset (stock, mutual fund) at year end, a gain will be recognized on settlement date (usually 5 days after transaction), while a loss will be recognized when the transaction is completed (usually same day).

--IRS Pub 521, Moving Expenses, is an excellent guide to insuring you capture all relevant expenses, especially if you sell a house along with your move.

--Use the last page of the Form 1040 instruction book to order any number of IRS publications which deal with specific tax areas. Do this before paying for investment or tax advice from a CPA or tax lawyer. Plus you can later

check on the quality of his paid-for advice.

--Check Form 8332, Release of Claim to exemption for child of Divorced or Separated Parents, to determine which parent can claim the child as a dependent.

--If you receive a state or local income tax refund of $10. or more, the refund may be taxable unless you did not deduct the tax in a prior year.

--The deduction for use of a car in performing service for a charitable organization is 12 cents a mile.

--If you have a household employee, you may have to pay employment taxes. See chapter 35 of IRS Pub. 17 for details.

--You can make a voluntary contribution to reduce the public debt. To do so, enclose a separate check, payable to: Bureau of the Public Debt, with your income tax return. Maybe we, the American taxpayer, can do something that the Congress can not do...

WEALTH BUILDING STRATEGIES

1. Understand the five basic ways to reduce income taxes:

   -convey

   -exclude

   -deduct

   -defer

   -shift

2. Learn the ways that different types of income and expenses are taxed in order to maximize your after-tax income and earnings. It is what you have left that counts.

3. Use the tax-savings tips to start your tax planning for next year early in the year. Don't wait until it is to late.

4. If you receive a refund on your taxes which exceeds 10% of your total

taxes, you are withholding to much, therefore making an interest-free loan to the Treasury. Re-examine the level of your withholding and file another W-4 with your finance officer if appropriate.

PART II

Part I of this publication has detailed for you a strategic framework for analyzing your financial posture, for providing a direction to your financial future, and for identifying the steps that will help accomplish your various objectives in life.

It is now time for your to take similar action. To answer the questions of: How do I get started? Where do I get the money to start a program? completion of the forms in this part will start you on your way. They provide you with a framework for making financial decisions by helping you:

- define your personal objectives
- begin to accumulate investment assets
- increase your cash flows
- protect your assets from inflation and taxes
- build long-term security for retirement purposes.

You now have in your possession all of the tools needed to become financially independent. It is now up to you to take the first step by completing the forms found in this part and updating them as your personal and financial situation changes. Good Luck!!

Date: ____________

FORM 1 PERSONAL AND FAMILY DATA

1. YOU

Name: ______________________ Birth Date: __________

SSAN: ______________________ Citizenship: __________

2. YOUR SPOUSE

Name: ______________________ Birth Date: __________

SSAN: ______________________ Citizenship: __________

3. YOUR PRESENT HOME

Address: ____

Telephone: ____________________

4. HOME OF RECORD: ____

5. CURRENT ASSIGNMENT

Unit: ____

Address: ____

Telephone: ____________________

Position: ____________________

6. SPOUSE'S OCCUPATION

Business Address: ____

Employer's Name: ____

Address: ____

Telephone: ____

Position: ____________________

7. CHILDREN/GRANDCHILDREN

NAME	BIRTH DATE	SSAN
______________________	__________	_____________
______________________	__________	_____________
______________________	__________	_____________

8. OTHERS DEPENDENT ON YOU

NAME	RELATIONSHIP	SSAN	AMOUNT OF SUPPORT
__________________	_______	___________	___________
__________________	_______	___________	___________
__________________	_______	___________	___________

9. DATE OF COMMISSION ____________

10. DATE ENTERED ON ACTIVE DUTY ____________

11. DATE OF RANK/PROMOTION ____________

12. DATE ELIGIBLE FOR RETIREMENT ____________

Date: ____________

FORM 2 FINANCIAL DOCUMENTS

LOCATION CODE:

SD Safe Deposit box located at ________________________________.
HF At home in fireproof file cabinet
HD At home in desk
AT Attorney's office
BR Broker's office
AM Army Mutual Aid Ass.
PA Parents' home
OA Other

	DESCRIPTION	LOCATION
YOUR WILL	________________________	__________________
SPOUSE'S WILL	________________________	__________________
MORTGAGES	________________________	__________________
TRUST DOCUMENTS	________________________	__________________
PROPERTY DEEDS	________________________	__________________
CAR TITLES	________________________	__________________
	________________________	__________________
STOCK CERTIFICATES	________________________	__________________
	________________________	__________________
	________________________	__________________
	________________________	__________________
MUTUAL FUND CERTIFICATES	________________________	__________________
	________________________	__________________
	________________________	__________________
BONDS	________________________	__________________
	________________________	__________________

CERTIFICATES OF DEPOSIT/T-BILLS ____________________ ____________________

____________________ ____________________

REAL ESTATE CONTRACTS ____________________ ____________________

____________________ ____________________

CHECKING A/C ____________________ ____________________

____________________ ____________________

LIFE INSURANCE POLICIES ____________________ ____________________

____________________ ____________________

____________________ ____________________

AUTO AND OTHER INS. POLICIES ____________________ ____________________

____________________ ____________________

____________________ ____________________

BIRTH CERTIFICATES ____________________ ____________________

____________________ ____________________

____________________ ____________________

____________________ ____________________

MARRIAGE LICENSE ____________________ ____________________

DIVORCE PAPERS ____________________ ____________________

INCOME TAX RE-TURNS ____________________ ____________________

MILITARY DOC. ____________________ ____________________

SAFE DEPOSIT KEYS ____________________ ____________________

WHO HAS ACCESS ____________________ ____________________

OTHER RECORDS AND VALUABLES ____________________ ____________________

Date: ____________

FORM 3 FINANCIAL ADVISORS

List your current financial advisors.

ATTORNEY

Name: ________________ Address: ____________________

Firm: ________________ Phone: ____________________

BANKING OFFICER

Name: ________________ Address: ____________________

Firm: ________________ Phone: ____________________

STOCKBROKER

Name: ________________ Address: ____________________

Firm: ________________ Phone: ____________________

CPA

Name: ________________ Address: ____________________

Firm: ________________ Phone: ____________________

LIFE INSURANCE AGENT

Name: ________________ Address: ____________________

Firm: ________________ Phone: ____________________

PROPERTY AND LIABILITY INSURANCE AGENT

Name: ________________ Address: ____________________

Firm: ________________ Phone: ____________________

Date: ____________

FORM 4 STATEMENT OF NET WORTH

ASSETS	CURRENT MARKET VALUE (EST)	% OF TOTAL ASSET VALUE
1. Liquid Assets(Protection of Principal)		
Cash and checking/savings accounts	________	____
Short-Term Investments:		
Treasury Bills	________	____
Saving Certificates	________	____
Money Market Funds	________	____
Series E/EE/H Bonds	________	____
Cash Value of Life Insurance	________	____
Other	________	____
TOTAL LIQUID ASSETS	________	____
2. INVESTMENT ASSETS(Income and Growth)		
Notes Receivable	________	____
Mutual Funds	________	____
Stocks	________	____
Bonds	________	____
Real Estate (Investment)	________	____
Limited Partnerships	________	____
Annuities	________	____
Retirement Funds (IRA/Pension)	________	____
Other	________	____
TOTAL INVESTMENT ASSETS	________	____

	CURRENT VALUE	%
3. Personal Assets		
Residence	___	___
Vacation Property	___	___
Collections (Art, Antiques)	___	___
Furnishings	___	___
Vehicles	___	___
Recreational	___	___
Jewelry/Furs	___	___
Other	___	___
TOTAL PERSONAL ASSETS	___	___
TOTAL ASSETS	___	100%

DEBTS/LIABILITIES

	CURRENT BALANCE (EST)	INTEREST RATE
4. Short-Term Obligations:		
Credit cards	___	___
Life Insurance Loans	___	___
Installment Loans	___	___
Personal/Family Loans	___	___
Accrued(Unpaid) Income Taxes	___	___
Accrued(Unpaid) Property Taxes	___	___
Other Obligations	___	___
"	___	___
TOTAL SHORT TERM OBLIGATIONS	___	___

	CURRENT BAL. (EST)	INTEREST RATE
5. Long-Term Obligations		
Loans to purchase personal assets	____________	__________
Loans to purchase investment assets	____________	__________
Mortgages:		
Residence	____________	__________
Rental	____________	__________
Other	____________	__________
Alimony	____________	__________
Child Support	____________	__________
TOTAL LONG-TERM OBLIGATIONS	____________	__________
TOTAL DEBTS/LIABILITIES	____________	__________

TOTAL ASSETS ____________

MINUS

TOTAL LIABILITIES ____________

NET WORTH ____________

Date:____________

FORM 5 ANALYSIS OF NET WORTH (1)

	AMOUNT	AMOUNT	PERCENT
LIQUIDITY			
1. Total Liquid Assets	________		____
2. Total Short-Term Debts/Obl.	________		____
3. Excess (deficiency) of Liquid Assets (1-2)		________	____
INVESTMENT ASSETS			
4. Total Investment Assets	________		____
5. Total Long-Term Investment Loans	________		____
6. Total Equity in Investment Assets (4-5)		________	____
PERSONAL ASSETS			
7. Total Personal Assets	________		____
8. Total Long-Term Personal Loans	________		____
9. Total Equity in Personal Assets (7-8)		________	____
TOTAL NET WORTH (3+6+9)	________	________	100%

(1). Use data from Form 4.

Date:______________

FORM 6 INCOME SOURCES

	YOU	SPOUSE	TOTAL
1. Income from Employment:			
Salary	______	______	______
Military Allowances (BAQ,VHA,BAS,ETC.)	______	______	______
Business Income	______	______	______
Self Employment	______	______	______
Other	______	______	______
Total Employment Income	______	______	______
2. Investment Income			
Taxable Interest	______	______	______
Nontaxable Interest	______	______	______
Dividends and Capital Gains	______	______	______
Rents (net of expenses)	______	______	______
Limited Partnerships	______	______	______
Other	______	______	______
Total Income From Investments	______	______	______
TOTAL INCOME FROM ALL SOURCES	______	______	______
INVESTMENT INCOME AS PERCENTAGE OF TOTAL INCOME	______	______	______

Date: ____________

FORM 7 BASIC LIFESTYLE EXPENDITURES (ANNUAL)

	AMOUNT	AMOUNT	PERCENT
1. Housing			
Mortgage or Rent	______		____
Utilities and Telephone	______		____
Property Taxes	______		____
Insurance	______		____
House and Yard Up Keep and Repairs/Maint.	______		____
Other	______		____
Total Housing Costs		______	____
2. Food		______	____
3. Clothing and Cleaning		______	____
4. Transportation			
Installment Payments	______		____
Insurance	______		____
Taxes	______		____
Fuel	______		____
Maintenance	______		____
Other	______		____
Total Transportation Expenditures		______	____
5. Household Purchases and Supplies		______	____
6. House Cleaning and Help		______	____
7. Recreation and Club Membership		______	____
8. Personal Care		______	____

	AMOUNT	PERCENT
9. Medical and Dental, Health and Disability Insurance	____	____
10. Life Insurance	____	____
11. Property and Liability Insurance	____	____
12. Other Insurance	____	____
13. Professional Dues (AUSA, ROA, ETC)	____	____
14. Debt Payments (Other than 1 & 4)	____	____
15. Charitable Contributions	____	____
16. Other Basic Lifestyle Costs	____	____
TOTAL BASIC LIFESTYLE EXPENDITURES	____	100%
AVERAGE MONTHLY COSTS (Divide by 12)	____	

Date:______________

FORM 8 DISCRETIONARY EXPENDITURES (ANNUALLY)

		AMOUNTS	PERCENT
1.	Education	______	____
2.	Entertainment and Eating Out	______	____
3.	Vacations	______	____
4.	Irregular Charitable Contributions	______	____
5.	Hobbies	______	____
6.	Personal Gifts	______	____
7.	Support of Relatives and Others (Voluntary)	______	____
8.	Home Improvements	______	____
9.	Purchase of Auto, boat, TV, etc.	______	____
10.	Retirement Plan Contribution	______	____
11.	Debt Payments	______	____
12.	Household Furnishings	______	____
13.	Medical and Dental Exp.	______	____
14.	Other	______	____
	TOTAL DISCRETIONARY EXPENDITURES	______	100%
	AVERAGE MONTHLY COSTS (Divide by 12)	______	

Date:____________

FORM 9 INCOME AND EMPLOYMENT TAXES (1)

1. Taxable Income __________

2. Federal Income Tax ________

3. State and City/County Tax ________

4. Employment Taxes

   Employee Social Security ______

   Self Employment Tax ______

   Total Employment Tax ________

5. TOTAL INCOME AND EMPLOYMENT TAXES __________

6. NET TAXABLE INCOME AFTER TAXES __________

7. MARGINAL TAX BRACKET AFTER TAXES __________
   (From tax schedule)

(1). Utilize last year's Income Tax Return and W-2's as basis.

MARGINAL TAX BRACKETS
1986 Joint Return

$21,800 to $26,550 - 22%

$26,550 to $32,270 - 25%

$32,270 to $37,980 - 28%

$37,980 to $49,420 - 33%

$49,420 to $64,750 - 38%

$64,750 to $92,370 - 42%

Date: ____________

FORM 10 ANALYSIS OF EARNED INCOME AND EXPENDITURES

	AMOUNT	AMOUNT	PERCENT OF TOTAL INCOME
1. TOTAL INCOME (Form 6)		_____	100%
2. EXPENDITURES			
Basic Lifestyle (Form 7)	______		___
Discretionary (Form 8)	______		___
Taxes (Form 9)	______		___
TOTAL		_____	___
3. NET INCOME (OR DEFICIENCY)		_____	___

Date:__________

FORM 11 TAX-PLANNING WORKSHEET

	LAST YEAR	CURRENT YEAR
1. Gross Income		
- Taxable Wages/Salaries/commissions	______	______
- Taxable Interest and Dividends	______	______
- Net Business Income (Loss)	______	______
- Net Taxable Long-Term Capital Gain (Loss)	______	______
- Net Taxable Short-Term Capital Gain (Loss)	______	______
- Net Rent Income (Loss)	______	______
- Net Partnership Income (Loss)	______	______
- Other Income (Loss)	______	______
TOTAL GROSS INCOME	______	______
2. Adjustments to Gross Income		
- Alimony Paid	______	______
- IRA Payments	______	______
- Keogh Plan Payments (Spouse)	______	______
- Unreinbursed Business Exp.	______	______
- Unreinbursed Moving Exp.	______	______
- Deduction for Married Couple when both work	______	______
- IRA/CD Interest Penalty (early withdrawals)	______	______
- Other Adjustments	______	______
TOTAL ADJUSTMENTS	______	______
3. ADJUSTED GROSS INCOME	______	______

	LAST YEAR	CURRENT YEAR
4. Itemized Deductions		
- Medical	______	______
- Taxes	______	______
- Interest Paid	______	______
- Charitable Contributions	______	______
- Casualty and Theft losses	______	______
- Miscellaneous Deductions	______	______
Total Deductions	______	______
Less Standard Deduction (\$3540 for 1985 Jt. filing) (\$3670 for 1986 Jt. filing.)	______	______
TOTAL EXCESS DEDUCTIONS	______	______
5. Personal Exemptions (\$1040 in 1985; \$1080 in 1986)	______	______
6. TAXABLE INCOME	______	______
7. Marginal Tax Bracket (See Form 9)	______	______

Date:__________

FORM 12 INSURANCE COVERAGE

YOUR LIFE

Ins. Co.	Policy #	Beneficiary	Type	Face Amt.	Cash Sur. Value	Owner
SGLI						
			Totals			

YOUR SPOUSE

Ins. Co.	Policy #	Beneficiary	Type	Face Amt.	Cash Sur. Value	Owner
			Totals			

PROPERTY AND LIABILITY

Ins. Co.	Policy #	Asset covered	Liability limits	Premiums(net)

AUTO

Date: ____________

FORM 13 TOTAL LIFE INSURANCE REQUIRED

1. Cash Required Immediately

   a. Funeral ________

   b. Current bills ________

   c. Emergency fund ________

   d. Administrative ________

   e. Other ________

   TOTAL _______

2. Cash Available Immediately

   a. Death Gratuity ________

   b. Insurance proceeds ________

   c. Liquid savings ________

   d. Other ________

   TOTAL _______

3. Net Cash Available (shortage) ________

4. Assets Required for Mortgage and Children's Education

   a. Mortgage ________

   b. Education ________

   TOTAL _______

5. Assets Available for Mortgage and Children's Education

   a. Investment assets ________

   b. Insurance Proceeds ________

   c. Other ________

   TOTAL _______

6. Net Resources Available (or Required) ________

7. Living Expenses (80% of current Total Income) TOTAL ______

8. Surviving Spouse's income (include SBP/DIC/SS) TOTAL ______

9. Net Resources Available (or Required) ________

10. Total Resources Available (or Required) (Lines 3 + 6 + 9) ________

8. APPROXIMATE AMOUNT OF ADDITIONAL LIFE INSURANCE NEEDED (Line 10 divided by .08)* ________

* = Estimated return on risk-free investments such as US Treasury Bonds. Adjust this figure to fit your assumptions.

Date: ___________

FORM 14 MEETING YOUR FINANCIAL GOALS THROUGH SAVING

1. Amount of money needed for a single objective based on current costs, for example, a down payment on a house, children's educational expenses: $_________.

2. Multiply the annual amount of money needed (Line 1) by the appropriate figure (table below) based on the number of years before you need the funds: $______. (Use Line 1 figure if all funds are needed in one year)

# of years	Factor at 10% Annual Growth
4	3.49
5	4.17
10	6.76
15	8.37
20	9.36

3. Amount you will need, adjusted for inflation: $_________.

   Multiply line 2. by the appropriate factor from the following table, which assumes an annual inflation rate of 5%.

Years to goal	Factor
5	1.28
10	1.63
15	2.08
20	2.65

4. Current value of assets set aside for this particular goal: $_________.

5. What will these assets be worth when you need them: $_________.

   Multiply line 4 by the appropriate factor from the following table. Choose the rate of return that you think you can earn. Remember, the higher the return, the higher the risk.

Years to goal	10%	15%	20%
5	1.61	2.01	2.49
10	2.60	4.05	6.19
15	4.18	8.14	15.41
20	6.73	16.37	38.34

6. Total you need to raise to meet your goal: $__________.

(Subtract line 5 from line 3.)

7. Amount you must put aside each month to reach the total: $

Multiply line 6 by the appropriate factor from the following table

Years to goal	10%	15%	20%
5	.013	.011	.010
10	.005	.004	.003
15	.002	.001	.0009
20	.001	.0007	.0003

Estimated annual total returns

5 to 10%	10 to 15%	15 to 25%
Treasury Bills	Bond Funds	Growth Stocks
CDs	Growth & Income Funds	Capital Appreciation Funds
Money Market Funds	Income Limited Partnerships	Growth Limited Partnerships
Real Estate	Annuities	
Saving Accounts	Utility Stocks	

Date:__________

FORM 15 FINANCIAL OBJECTIVES

1. Indicate your preference to the following considerations utilizing the scale below(1-10):

Not important	1
Moderately important	5
Extremely important	10

Diversification of Assets	__________
Safety of Principal	__________
Liquidity/Marketability of assets	__________
Current Income	__________
Capital Growth (Appreciation)	__________
Tax Advantage Investments	__________
Reduction of Income Taxes	__________
Support of Parents &/or others	__________
Providing for college education	__________
Providing for a comfortable retirement	__________
Protecting Spouse/Children in case of my death	__________

2. Which of the above objectives will be most important for you during the next three years? ______________________________________

3. What is your estimate of the inflation rate for the next three years?__

4. What annual after-tax total return on your investments do you want to achieve over the next three years? _____

5. Of your current investments, which ones will provide you with the level of after-tax total returns you expect? What amounts are invested in each?

____

____

____

Total Amount ____________

6. Which of your current investments do not either match your current investment objectives or do not earn the level of pre-tax returns you expect? What amounts are invested in each?

____

____

____

____

Total Amount ____________

7. Into what new investments should you reposition these assets?

Current Investments	New Investments	Est. Total Return

Total Amount ____________

8. What kind of assets (stock, real estate, etc.) represent the largest percentage of your present investment portfolio?

Asset: ____________ Percentage: ______

9. Is your current portfolio sufficiently diversified based upon your objectives ? Yes ____ No ___. If not, what changes are required?

____

____

____

10. Is your emergency fund sufficiently funded (minimum of 3 months of take home salary)? Yes ____ No ___. If not, when and where will you properly fund this essential requirement?

____

11. Are there any debts which should be liquidated by selling assets?

Yes _____ Which ones? ______________________________

No _____

Date:____________

FORM 16 FINANCIAL SECURITY

1. What does financial security mean to you?

____

____

____

2. What does financial security mean to your wife and other family members?

____

____

____

3. In how many years from now would you like to achieve financial security?

______

4. List the three greatest obstacles to your achieving financial security?

____

____

____

5. What is your estimated total income for each year:

	CURRENT YEAR	NEXT YEAR	THIRD YEAR
You	______	______	______
Spouse	______	______	______
Joint	______	______	______

6. How much (Percentage) could you reduce your basic lifestyle expenditures?

______ discretionary expenditures? ______

7. What major discretionary expenditures (except education) do you plan to incur in the next three years(cars, travel, home purchase/improvements)?

$______ $______ $______

Yr.______ Yr.______ Yr.______

8. What will be your estimated educational expenses for your dependents?

NAME	AGE	YRS OF SCHOOLING	YR. COST	TOTAL COSTS

TOTAL EST. COSTS__________

9. When do you plan to retire from Active Duty? __________

Your age __________

Your Spouse's age __________

Number of years from now __________

10.Estimate your retirement income:

Source	Est. Annual Amount
Military Retirement	__________
Second Income	__________
Spouse's Income	__________
Investment Assets	__________
IRA Plan	__________
Other	__________
Total Est. Income	__________

11.How much of your total estimated income, before and after military retirement can be set aside for investment each year?

Before:$__________ X # of yr. before retirement_____= ________

After: $__________ X # of est. yr. in second job____= ________

Est. total________

Date: ______

FORM 17 INCOME AND EXPENDITURE PROJECTION

	Actual	Projected	
	Last Year	This Year	Next Year
1. Total Income	______	______	______
2. Expenditures			
Basic Lifestyle	______	______	______
Discretionary	______	______	______
Taxes	______	______	______
Total	______	______	______
3. Net Income	______	______	______
LONG-TERM OBJECTIVES:			
4. Education Costs	______	______	______
5. Investment Funds	______	______	______
6. Retirement Funds	______	______	______
7. Other Objectives	______	______	______
8. Total Cost Req.	______	______	______
9. Funding Capability (line 8 - line 3)	______	______	______

If line 3 is greater than line 8, sufficient funds are available to ...ance your long-term objectives. If not, then you must determine where you will obtain the required funds: reduce discretionary expenses, reposition available funds to higher yielding investments, or reduce the level of your long-term objectives. Your strategy is to balance line 3 and 8.

Date:__________

FORM 18 PROPERTY OWNERSHIP AND ESTATE VALUES

	Est. Current value	Joint	OWNERSHIP --------- Comm.	Husband	Wife
1. NET WORTH					
a. Liquid assets	____	____	____	____	____
b. Invest. assets	____	____	____	____	____
c. Personal assets	____	____	____	____	____
Total assets	____				
d. Liabilities	____	____	____	____	____
Net Worth	____				
2. INSURANCE OWNED					
a. On your life	____	____	____	____	____
b. On Spouse's life	____	____	____	____	____
Total	____				
3. OTHER ESTATE ASSETS					
a. Retirement plans	____	____	____	____	____
b. Other	____	____	____	____	____
TOTAL	____				
4. TOTAL GROSS ESTATE	____				
5. TOTAL GROSS ESTATE:					
a. You	____				
b. Your spouse	____				

Date:____________

FORM 19 PLAN OF ACTION

1. List at least five specific steps you will take during the next year to put your financial plan into action: (Use Form 15 as guide)

____

____

____

____

____

____

____

2. My and my spouse's will are current (drawn up since 1981) and reflect our present desires for the handling of our respective estates.

   Husband: Yes ___ No ____ Wife: Yes ___ No ____

   If no, date to see the legal assistance officer:

   Husband: ________________ Wife: ________________

3. I have fully funded this year's IRA. Yes: ____ No: ___

   If no, date to complete: ______________

Please review this plan yearly. Its' importance to you and your family will not become apparent until you begin to reap the benefits of the time and effort put into its execution. Good Luck!

Contents and Operational Checklist for each File of Financial Records

Heading	Contents	Operational Checklist
General	Personal information sheet ● List of items in safe-deposit box ● Letters of last instruction ● Copy of will	Update information sheet to reflect changes ● Update safe-deposit box list as items are added/eliminated
Budgeting	Goals ● Income statement/balance sheet ● Old budget control sheets	Review budget planning sheets ● Revise goals if necessary
Housing	Purchase contract/receipt ● Mortgage papers ● Home improvement and property tax receipts ● Termite inspection/policy ● Copy of lease	Keep home improvement records to establish accurate cost basis if you ever sell your home
Property Insurance	Coverage ● Personal property inventory ● Photos of high-value items (put negatives in safe-deposit box)	Change insurance limits annually to reflect changes in personal property holdings replacement costs ● Update personal property inventory yearly ● Take more pictures if necessary ● Shop for rates
Auto Insurance	Coverage ● Record of traffic violations and accidents ● Auto registration receipts	Update annually by adding new cars. amending coverages raising drivers ages ● Shop for rates
Health Insurance	CHAMPUS supplements ● Employee health plans ● Current medical history for each family member	Update to reflect changes in limits coverage ● Update medical histories ● Shop for rates
Life Insurance	Policies owned including employee group plans ● Determination of life insurance needs	Recompute needs every five years—sooner if financial situation changes significantly ● Update to reflect changes in beneficiaries and coverage increases in employee policies
Investments— **Stocks,** **Bonds,** **Mutual Funds**	Purchase and sale records (certificates either with broker or in safe-deposit box) ● Stock dividend and bond interest records ● Stock certificate numbers and dates of issue	Update to reflect purchases and sales evidenced by transaction slips ● Add new stock numbers and issue dates (if certificates are sent to you) ● Store each year's transaction and monthly statements in an envelope
Tax	Purchase receipts. interest payment records charitable gift confirmations. medical expense records ● Tax forms schedules. supporting data for past 10 years	File receipts required to substantiate deductions ● Store receipts and substantiating records after annual tax form is filed
Guarantees & Warranties	Appliance tire carpet. warranties ● Receipts repair instructions	Add items to file as soon as purchased ● Remove annually all that have expired
Employment Information	Employment contract if any ● Employee handbook	Update as necessary
Personal Resume	Education years major. degree(s). professors. advisors (with addresses. phone numbers) ● Employment record job titles dates. responsibilities supervisors names, addresses	Put information from employment file in here when you switch jobs
Credit Records	Papers showing resolution of debts ● Credit card numbers. names addresses ● Notification forms for lost or stolen cards	Update as necessary

TABLE 1
FUTURE WORTH OF ONE DOLLAR WITH AMOUNT OF RETURN COMPOUNDED ANNUALLY

	Annual Rate of Return										
Year	**5%**	**6%**	**7%**	**8%**	**9%**	**10%**	**11%**	**12%**	**13%**	**14%**	**15%**
1	1.05	1.06	1.07	1.08	1.09	1.10	1.11	1.12	1.13	1.14	[illegible]
2	1.10	1.12	1.15	1.17	1.19	1.21	1.23	1.25	1.28	1.30	[illegible]
3	1.16	1.19	1.23	1.26	1.30	1.33	1.37	1.40	1.44	1.48	[illegible]
4	1.22	1.26	1.31	1.36	1.41	1.46	1.52	1.57	1.63	1.69	[illegible]
5	1.28	1.34	1.40	1.47	1.54	1.61	1.69	1.76	1.84	1.93	[illegible]
6	1.34	1.42	1.50	1.59	1.68	1.77	1.87	1.97	2.08	2.20	2.31
7	1.41	1.50	1.61	1.71	1.83	1.95	2.08	2.21	2.35	2.50	2.6[illegible]
8	1.48	1.59	1.72	1.85	1.99	2.14	2.31	2.48	2.66	2.85	3.0[illegible]
9	1.55	1.69	1.84	2.00	2.17	2.36	2.56	2.77	3.00	3.25	3.52
10	1.63	1.79	1.97	2.16	2.37	2.59	2.84	3.10	3.40	3.71	4.05
11	1.71	1.90	2.11	2.33	2.58	2.85	3.15	3.48	3.84	4.23	4.65
12	1.80	2.01	2.25	2.52	2.81	3.14	3.50	3.90	4.34	4.82	5.35
13	1.89	2.13	2.41	2.72	3.07	3.45	3.88	4.36	4.90	5.50	6.15
14	1.98	2.26	2.58	2.94	3.34	3.80	4.31	4.89	5.54	6.26	7.08
15	2.08	2.40	2.76	3.17	3.64	4.18	4.79	5.47	6.25	7.14	8.14
16	2.18	2.54	2.95	3.43	3.97	4.60	5.31	6.13	7.07	8.14	9.36
17	2.30	2.69	3.16	3.70	4.33	5.05	5.90	6.87	7.99	9.28	10.76
18	2.41	2.85	3.38	4.00	4.72	5.56	6.54	7.69	9.02	10.58	12.38
19	2.53	3.03	3.62	4.32	5.14	6.12	7.26	8.61	10.20	12.06	14.23
20	2.65	3.21	3.87	4.67	5.60	6.73	8.06	9.65	11.52	13.74	16.37
21	2.79	3.40	4.14	5.03	6.11	7.40	8.95	10.80	13.02	15.67	18.82
22	2.93	3.60	4.43	5.44	6.66	8.14	9.93	12.10	14.71	17.86	21.65
23	3.07	3.82	4.74	5.87	7.26	8.95	11.03	13.55	16.63	20.36	24.89
24	3.23	4.05	5.07	6.34	7.91	9.85	12.24	15.18	18.79	23.21	28.63
25	3.39	4.29	5.43	6.86	8.62	10.83	13.59	17.00	21.23	26.46	32.92
26	3.56	4.55	5.81	7.40	9.40	11.92	13.08	19.04	23.99	30.17	37.86
27	3.73	4.82	6.21	7.99	10.25	13.11	16.74	21.33	27.11	34.39	43.54
28	3.92	5.11	6.65	8.63	11.17	14.42	18.58	23.88	30.63	39.20	50.0[illegible]
29	4.12	5.42	7.11	9.32	12.17	15.86	20.62	26.75	34.62	44.69	57.58
30	4.32	5.74	7.61	10.06	13.27	17.45	22.90	29.96	39.12	50.95	66.21
31	4.54	6.09	8.15	10.87	14.46	19.19	25.41	33.56	44.20	58.08	76.14
32	4.77	6.45	8.72	11.74	15.76	21.11	28.21	37.58	49.95	66.22	87.57
33	5.00	6.84	9.33	12.68	17.18	23.23	31.31	42.09	56.44	75.49	100.70
34	5.25	7.25	9.98	13.69	18.73	25.55	34.75	47.14	63.78	86.05	115.81
35	5.52	7.69	10.68	14.79	20.41	28.10	38.58	52.80	72.07	98.10	133.18
36	5.79	8.15	11.42	15.97	22.25	30.91	42.82	59.14	81.44	111.83	153.15
37	6.08	8.64	12.22	17.25	24.25	34.00	47.53	66.23	92.02	127.49	176.13
38	6.39	9.15	13.08	18.63	26.44	37.40	52.76	74.18	103.99	145.34	202.54
39	6.71	9.70	14.00	20.12	28.82	41.15	58.56	83.08	117.51	165.69	232.93
40	7.04	10.29	14.97	21.73	31.41	45.26	65.00	93.05	132.78	188.88	267.86

TABLE 2
FUTURE WORTH OF ONE DOLLAR INVESTED EACH YEAR WITH INTEREST (RETURN) PAYABLE AND REINVESTED AT END OF EACH YEAR

	Annual Rate of Return										
Year	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%
1	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
2	2.05	2.06	2.07	2.08	2.09	2.10	2.11	2.12	2.13	2.14	2.15
3	3.15	3.18	3.22	3.25	3.28	3.31	3.34	3.37	3.41	3.44	3.47
4	4.31	4.37	4.44	4.50	4.57	4.64	4.71	4.78	4.85	4.92	4.99
5	5.53	5.64	5.75	5.87	5.99	6.10	6.23	6.35	6.48	6.61	6.74
6	6.80	6.98	7.15	7.33	7.52	7.71	7.91	8.11	8.32	8.54	8.75
7	8.14	8.39	8.65	8.92	9.20	9.49	9.78	10.09	10.41	10.73	11.07
8	9.55	9.90	10.26	10.64	11.03	11.43	11.86	12.30	12.76	13.23	13.73
9	11.03	11.49	11.98	12.49	13.02	13.58	14.16	14.77	15.42	16.09	16.78
10	12.58	13.18	13.82	14.49	15.19	15.94	16.72	17.55	18.42	19.34	20.30
11	14.21	14.97	15.78	16.65	17.56	18.53	19.56	20.66	21.81	23.05	24.35
12	15.92	16.87	17.89	18.98	20.14	21.38	22.71	24.13	25.65	27.27	29.00
13	17.71	18.88	20.14	21.50	22.95	24.52	26.21	28.03	29.99	32.09	34.35
14	19.60	21.02	22.55	24.22	26.02	27.98	30.10	32.39	34.88	37.58	40.51
15	21.58	23.27	25.13	27.15	29.36	31.77	34.41	37.28	40.42	43.84	47.58
16	23.66	23.67	27.89	30.32	33.00	35.95	39.19	42.75	46.67	50.98	55.72
17	25.84	28.21	30.84	33.75	36.97	40.55	44.50	48.88	53.74	59.12	65.08
18	28.13	30.91	34.00	37.45	41.30	45.60	50.40	55.75	61.73	68.39	75.84
19	30.54	33.76	37.38	41.45	46.02	51.16	56.94	63.44	70.75	78.97	88.21
20	33.07	36.78	41.00	45.76	51.16	37.27	64.20	72.05	80.95	91.03	102.44
21	35.72	39.99	44.87	50.42	56.77	64.00	72.27	81.70	92.47	104.77	118.81
22	38.51	43.39	49.01	55.46	62.87	71.40	81.21	92.50	105.49	120.44	137.63
23	41.43	47.00	53.44	60.89	69.53	79.54	91.15	104.60	120.21	138.30	159.28
24	44.50	50.82	58.18	66.77	76.79	88.50	102.17	118.16	136.83	158.66	184.17
25	47.73	54.86	63.25	73.10	84.70	98.35	114.41	133.33	155.62	181.87	212.79
26	51.11	59.16	68.88	79.95	93.32	109.18	128.00	150.33	176.85	208.33	245.71
27	54.67	63.71	74.48	87.35	102.72	121.10	143.08	169.37	200.84	238.50	283.57
28	58.40	68.53	80.70	95.34	112.97	134.21	159.82	190.70	227.95	272.89	327.10
29	62.32	73.64	87.35	103.97	124.14	148.63	178.40	214.58	258.58	312.09	377.17
30	66.44	79.06	94.46	113.28	136.31	164.49	199.02	241.33	293.20	356.79	434.75
31	70.76	84.80	102.07	123.35	149.58	181.94	221.91	271.29	332.32	407.74	500.96
32	75.30	90.89	110.22	134.21	164.04	201.14	247.32	304.85	376.52	465.82	577.10
33	80.06	97.34	118.93	145.95	179.80	222.25	275.53	342.43	426.46	532.04	664.67
34	85.07	104.18	128.26	158.63	196.98	245.48	306.84	384.52	482.90	607.52	765.37
35	90.32	111.44	138.24	172.32	215.71	271.02	341.59	431.66	546.68	693.57	881.17
36	95.84	119.12	148.91	187.10	236.13	299.13	380.16	484.46	618.75	791.67	1,014.35
37	101.63	127.27	160.34	203.07	258.38	330.04	422.98	543.60	700.19	903.51	1,167.50
38	107.71	135.90	172.56	220.32	282.63	364.04	470.51	609.83	792.21	1,031.00	1,343.62
39	114.10	145.06	185.64	238.94	309.07	401.45	523.27	684.01	896.20	1,176.34	1,546.17
40	120.80	154.76	199.64	259.06	337.88	442.59	581.83	767.09	1,013.70	1,342.03	1,779.09

TABLE 3
$10,000 LUMP-SUM INVESTMENT COMPOUNDED ANNUALLY END-OF-YEAR VALUES

End of Year	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%
						Annual Rate of Return					
1	10,500	10,600	10,700	10,800	10,900	11,000	11,100	11,200	11,300	11,400	11,5[illegible]
2	11,025	11,236	11,449	11,664	11,881	12,100	12,321	12,544	12,769	12,996	13,2[illegible]
3	11,576	11,910	12,250	12,597	12,950	13,310	13,676	14,049	14,428	14,815	15,2[illegible]
4	12,155	12,624	13,107	13,604	14,155	14,641	15,180	15,735	16,304	16,889	17,4[illegible]
5	12,763	13,382	14,025	14,693	15,386	16,105	16,850	17,623	18,424	19,254	20,113
6	13,401	14,185	15,007	15,868	16,771	17,715	18,704	19,738	20,819	21,949	23,13[illegible]
7	14,071	15,036	16,057	17,138	18,280	19,487	20,761	22,106	23,526	25,022	26,6[illegible]
8	14,775	15,938	17,181	18,509	19,925	21,435	23,045	24,759	26,584	28,525	30,5[illegible]
9	15,513	16,894	18,384	19,990	21,718	23,579	25,580	27,730	30,040	32,519	35,178
10	16,289	17,908	19,671	21,589	23,673	25,937	28,394	31,058	33,945	37,072	40,455
11	17,103	18,982	21,048	23,316	25,804	28,531	31,517	34,785	38,358	42,262	46,523
12	17,959	20,121	22,521	25,181	28,126	31,384	34,984	38,959	43,345	48,179	53,502
13	18,856	21,329	24,098	27,196	30,658	34,522	38,832	43,634	48,980	54,924	61,527
14	19,799	22,609	25,785	29,371	33,417	37,974	43,104	48,871	55,347	62,613	70,757
15	20,789	23,965	27,590	31,721	36,424	41,772	47,845	54,735	62,542	71,379	81,370
16	21,829	25,403	29,521	34,259	39,703	45,949	53,108	61,303	70,673	81,372	93,576
17	22,920	26,927	31,588	37,000	43,276	50,544	58,590	68,660	79,860	92,764	107,612
18	24,066	28,543	33,799	39,960	47,171	55,599	65,435	76,899	90,242	105,751	123,754
19	25,270	30,255	36,165	43,157	51,416	61,159	72,633	86,127	101,974	120,556	142,317
20	26,533	32,071	38,696	46,609	56,044	67,274	80,623	96,462	115,230	137,434	163,665
21	27,860	33,995	41,405	50,338	61,088	74,002	89,491	108,038	130,210	156,675	188,215
22	29,253	36,035	44,304	54,365	66,586	81,402	99,335	121,003	147,138	178,610	216,447
23	30,715	38,197	47,405	58,714	72,578	89,543	110,262	135,523	166,266	203,615	248,914
24	32,251	40,489	50,723	63,411	79,110	98,497	122,391	151,786	187,880	232,122	286,251
25	33,864	42,918	54,274	68,484	86,230	108,347	135,854	170,000	212,305	264,619	329,189
26	35,557	45,493	58,073	73,963	93,991	119,181	150,798	190,400	239,905	301,665	378,567
27	37,335	48,223	62,138	79,880	102,450	131,099	167,386	213,248	271,092	343,899	435,353
28	39,201	51,116	66,488	86,271	111,671	144,209	185,799	238,838	306,334	392,044	500,656
29	41,161	54,183	71,142	93,172	121,721	158,630	206,236	267,499	346,158	446,931	575,754
30	43,219	57,434	76,122	100,626	132,676	174,494	228,922	299,599	391,158	509,501	662,117
31	45,380	60,881	81,451	108,676	144,617	191,943	254,104	335,551	442,009	580,831	761,435
32	47,649	64,533	87,152	117,370	157,633	211,137	282,055	375,817	499,470	662,148	875,650
33	50,032	68,405	93,253	126,760	171,820	232,251	313,082	420,915	564,402	754,849	1,006,998
34	52,533	72,510	99,781	136,901	187,284	255,476	347,521	471,425	637,774	860,527	1,158,048
35	55,160	76,860	106,765	147,853	204,139	281,024	385,748	527,996	720,685	981,001	1,331,775
40	70,399	102,857	149,744	217,245	314,094	452,592	650,008	930,509	1,327,815	1,888,835	2,678,635

TABLE 4
TURE WORTH OF $1,200 INVESTED EACH YEAR AT VARYING RATES COMPOUNDED EACH YEAR

Rate of Return	End of Year							
	5	10	15	20	25	30	35	40
5%	6,631	15,093	25,894	39,679	57,272	79,727	108,384	144,960
6%	6,764	15,817	27,931	44,143	65,837	94,870	133,722	185,714
7%	6,901	16,580	30,155	49,194	75,891	113,353	165,884	239,562
8%	7,040	17,384	32,583	54,914	87,727	135,940	206,780	310,868
9%	7,182	18,231	35,233	61,392	101,641	163,569	258,853	405,459
10%	7,326	19,125	38,127	68,730	118,016	197,393	325,229	531,111
11%	7,473	20,066	41,286	77,043	137,296	238,825	409,907	698,191
12%	7,623	21,058	44,736	86,463	160,001	289,599	517,996	920,510
13%	7,776	22,104	48,501	97,136	186,743	351,839	656,017	1,216,445
14%	7,932	23,205	52,611	109,230	218,245	428,144	832,287	1,610,430
15%	8,091	24,364	57,096	122,932	255,352	521,694	1,057,404	2,134,908

TABLE 5
RATES OF RETURN AND THE INVESTMENT AMOUNTS REQUIRED TO HAVE $100,000 AVAILABLE AT END OF SPECIFIED PERIOD

Rate of Return	End of Year							
	5	10	15	20	25	30	35	40
5%	78,353	61,391	48,102	37,689	29,530	23,138	18,129	14,205
6%	74,726	55,839	41,727	31,180	23,300	17,411	13,011	9,722
7%	71,299	50,835	36,245	25,842	18,425	13,137	9,367	6,678
8%	68,058	46,319	31,524	21,455	14,602	9,938	6,763	4,603
9%	64,993	42,241	27,454	17,843	11,597	7,537	4,899	3,184
10%	62,092	38,554	23,940	14,864	9,230	5,731	3,558	2,209
11%	59,345	35,218	20,900	12,403	7,361	4,368	2,592	1,538
12%	56,743	32,197	18,270	10,367	5,882	3,340	1,894	1,075
13%	54,276	29,460	15,989	8,678	4,710	2,557	1,388	753.12
14%	51,937	26,974	14,010	7,276	3,780	1,963	1,019	529.43
15%	49,718	24,718	12,289	6,110	3,040	1,510	750.89	373.32
16%	47,611	22,683	10,792	5,139	2,447	1,165	554.59	264.05
17%	45,611	20,804	9,489	4,329	1,974	900.38	410.67	187.31
18%	43,711	19,107	8,352	3,651	1,596	697.49	304.88	133.27
19%	41,905	17,560	7,359	3,084	1,292	541.49	226.91	95.10
20%	40,188	16,151	6,491	2,610	1,048	421.27	169.30	68.04
21%	38,554	14,864	5,731	2,209	851.85	328.43	126.62	48.82
22%	37,000	13,690	5,065	1,874	693.43	256.57	94.93	35.12
23%	35,520	12,617	4,482	1,592	565.42	200.84	71.34	25.34
24%	34,112	11,635	3,969	1,354	461.80	157.52	53.72	18.33

MONTHLY AMOUNT OF MILITARY NON-DISABILITY RETIREMENT PAY
(CURRENT AS OF 20 MARCH 1986)
(YEARS OF SERVICE ARE ASSUMED TO BE EQUAL TO YEARS OF ACTIVE SERVICE)
(ACTUAL AMOUNTS MAY VARY DUE TO ROUNDING)

PAY GRADE	OVER 20	OVER 21	OVER 22	OVER 23	OVER 24	OVER 25	OVER 26	OVER 27	OVER 28	OVER 29	OVER 30
O-10/ O-9	2862	3005	3149	3292	3435	3578	3721	3864	4007	4150	4294
O-8	2806	2947	3149	3292	3435	3578	3721	3864	4007	4150	4294
O-7	2537	2664	2791	2917	3044	3171	3298	3552	3679	3806	3932
O-6	1943	2040	2261	2364	2467	2570	2899	3010	3122	3233	3345
O-5	1758	1846	2001	2092	2183	2273	2364	2455	2546	2637	2728
O-4	1521	1597	1673	1749	1825	1901	1977	2053	2129	2205	2281
O-3E	1335	1401	1467	1533	1599	1665	1731	1797	1863	1929	1995
O-3	1315	1380	1445	1510	1575	1640	1705	1770	1835	1900	1965
O-2E	1130	1187	1243	1299	1355	1411	1467	1523	1579	1635	1691
O-2	957	1005	1053	1101	1149	1197	1245	1293	1341	1389	1437
O-1E	956	1004	1051	1098	1145	1192	1239	1286	1333	1380	1427
O-1	770	808	846	884	922	960	998	1036	1074	1112	1150
W-4	1263	1326	1436	1501	1566	1631	1829	1899	1969	2039	2109
W-3	1111	1166	1266	1324	1381	1439	1549	1606	1665	1724	1983
W-2	997	1046	1141	1193	1245	1297	1349	1401	1453	1505	1557
W-1	925	971	1017	1063	1109	1155	1201	1247	1293	1339	1385
E-9	1068	1122	1237	1293	1480	1542	1603	1664	1725	1786	1847
E-8	936	983	1090	1140	1189	1239	1432	1488	1543	1598	1653
E-7	826	867	970	1014	1058	1102	1288	1338	1387	1436	1485
E-6	724	760	796	832	868	904	940	976	1012	1048	1084
E-5	614	645	675	705	735	765	795	825	855	885	915
E-4	495	519	543	567	591	615	639	663	687	711	735
E-3	424	445	466	487	508	529	550	571	592	613	634
E-2	358	375	392	409	426	573	590	607	624	641	658
E-1	319	335	351	367	383	399	415	431	447	463	479

FINANCIAL PUBLICATIONS AND AIDS

The following publications and aids are easily available sources of financial information which will assist you in charting your course through a maze of details. Whether you go to the extreme of establishing a library or simply reading these sources, they will contribute to your becoming well informed on the various aspects of personal finances.

The publications can be found in most public or school libraries, or ordered from the publisher. Most of the investment reports advertise in Money, Forbes or Barron's Magazines. In addition, materials can be obtained from brokerage houses and national CPA firms, all which are more than willing to send you materials, generally with no obligation. Copies of the Wall Street Journal and Barron's also contain subscription information on most of the newsletters and investment materials outlined below. The best course of action is to take a trail subscription to ensure that the reports meet your needs.

PUBLICATIONS

Name	Frequency	Publisher	Contents
Barron's	Weekly	Dow Jones	General business and market quotes
Business Week	Weekly	McGraw-Hill	General business and economic news
Changing Times	Monthly	The Kiplinger Washington Ed.	Consumer interest
Consumer Reports	Monthly	Consumer Union	Consumer goods
Financial World	Semimonthly	Macro Communications	General Financial interest articles
Forbes	Semimonthly	Forbes, Inc.	Articles on Companies and investments
Fortune	Semimonthly	Time, Inc.	General business

Money	Monthly	Time, Inc.	Per. Finance articles
The Wall St. Journal	Daily	Dow Jones	General business and financial articles with market quotes.
U.S. News and World Report	Weekly	U.S. News & World Report	General business
FINANCIAL ADVICE			
Donoghue's Mut. Funds	Monthly	Donoghue	Mutual fund analysis
Dow Theory Forecast	Monthly	Dow Theory	Investment recom.
Dow Theory Letter	bimonthly	Dow Theory	Market timing adv.
Money Fund Safety Ratings	Monthly	Inst. for Econ. Res.	Safety ratings
Moody's Investors	Yearly	Moody's	Facts and figures
Mutual Fund Forecast.	Monthly	-	Mutual fund analysis
No-Load Fund Invest.	Monthly	-	Mutual fund analysis
No-Load Fund X	Monthly	No-Load Inc.	Mutual fund recomm.
No-load Mutual Fund Association	-	-	Free booklet
Personal Finance	Monthly	Per. Fin. Co.	Gen. financial info.
Prime Inv. Alert	bimonthly	Prime Fin.	Mutual fund recomm.
Standard and Poor's The Outlook	Weekly	S & P, Inc.	Specific investment advice and trends
Schabacker Inv.	Monthly	Schabacker	Mutual fund timing
Switch Fund Adv.	Monthly	Switch Fund	Mutual fund advice
Tax Hotline	Monthly	-	Tax tips and info.
Telephone Switch Newsletter	Monthly	-	Mutual fund advice
The Growth Fund Guide	Monthly	Growth Fund Research	Specific Mutual Fund investment advice
The Stranger Rep.	Monthly	Real Estate	Limited Partnership Analysis
United Mutual Fund	Monthly	United Bus.	Mutual fund analysis

Selector			
Wiesenberger Inv. Co. Service	Quarterly	Warren, Gorham & Lamont, Inc.	Mutual fund analysis
Zweig Forecast	Monthly	Zweig Inc.	Investment Advice

Comprehensive Guide to Investment Terms

Acceptance: Money-market instrument arising out of international trade.

Actuarial tables: Tables giving the life expectancy of various age groups, based on past experience. There are separate tables for men and women, for racial groups and for certain hazardous occupations. Such a table might indicate that at age 25, a white male would have one chance in 350 of dying within the next year and could on the average expect to live 46 more years (to age 71). For a 65-year-old white male, it would list his chance of dying in the next year as one in 10 and his future life expectancy as 10 years (to age 75).

ADR: American depository receipt – United States-traded securities representing stock in foreign corporations.

AMEX: American Stock Exchange.

Amortization: The gradual elimination of a debt through periodic payments.

Annual percentage rate (APR): The yield to maturity on a fixed-income investment or the rate of interest charged on a loan, computed using a compounding factor reflecting the balance still due.

Annuity: An agreement under which an amount is paid annually or at any other regular intervals.

Appreciation: An increasing in value or number.

Arbitrage: Simultaneous buying of a security in one market and selling of the same security in another, the object of which is to profit from the slight difference in price on the different exchanges.

Asset: Any item of value, usually income producing; frequently it appears on the left side of the balance sheet.

Balance sheet: Financial statement providing a snapshot picture of a financial position at a given date; presents assets, liabilities, and owner's equity at that date.

Banker's acceptance: A negotiable time draft in which a bank promises to lend a specified sum of money at a specified time in the future to a specified borrower.

Basis: Purchase price of an asset for tax purposes; the taxable gain is the difference between the sale price and the basis (usually purchase price, plus other expenses, less depreciation).

Bear market: A declining market.

Bear raid: An attempt to drive down the price of a stock by selling it short.

Beneficiary: A person named to receive property or other resources.

Source: New York Fin. Inst.

Bills: Short-term government debt securities issued by the US Treasury for periods of less than one year.

Block trade: Trade involving 10,000 shares or more; often handled by a stock trader.

Block trader: One who assembles orders on a block trade and manages the transaction.

Blue-chip stock: Shares of a large, mature company with a steady record of profit growth and dividend payouts and a high probability of continued growth and future earnings.

Bond: Long-term debt obligation by which the borrower promises to pay a set rate of interest for a given number of years until the bond matures and the principal must be repaid. Many bond issues are secured by a mortgage on a specific property, plant, or piece of equipment.

Book value of common shares: Total assets of an enterprise, minus liabilities and preferred stock, and divided by the number of outstanding common shares.

Broker: Financial intermediary who acts as an agent in the buying and selling of investments.

Bullion: Gold, silver or other metals in the form of bars, plates or certain coins minted to contain a specific unit of weight.

Bull market: A rising stock market.

Call: Option to buy stock at a specified price over specified time periods.

Call feature on bond or preferred stock: Option available to company to repurchase securities at a set price over a specified period.

Capital gains (losses): The difference between the purchase and sale price of an investment asset; if asset is held more than six months, it is considered long-term and only 40 percent of gain is taxable.

Cash-surrender value: Accumulated savings element at a point in time of a life-insurance policy that can be recovered on cashing in the policy or borrowed against at a specified interest rate.

Caveat emptor: A Latin term meaning, "Let the buyer beware." A warning that unscrupulous investment dealers exist, so the investor should be wary of any purchase.

CBOE: Chicago Board Options Exchange – an exchange that has promoted the organized trading of options.

Certificate of deposit (CD): A redeemable bond issued by a financial institution. Terms usually run from 90 days to four years.

Churning: Overactive trading of customer accounts in order to generate commission income for the broker.

Clifford Trust: A financial arrangement that permits a gift of a minimum of 10 years of income on an investment asset.

Collateral trust bond: Bond secured by specific assets; for example, equipment trust bonds are secured by railroad rolling stock.

Commercial Paper: Short-term, usually low-risk, debt issued by large corporations with good credit rating.

Commodity: In general, any article of commerce; in investment terminology, any of a select group of items traded on one of the commodity exchanges, either spot (for immediate delivery) or in the futures market (for delivery at a specified future date).

Common stock: The residual ownership of an incorporated enterprise; common stockholders have the residual claim on earnings and assets after all debt and preferred-stock obligations have been met.

Compound interest: Returns are compounded by investing a previous gain so that it earns a return the following year. Thus, at 9 per cent, $100 yields $9 the first year. In the following year the 9 per cent is applied to $109 for a return of $9.81. In the third year the principal grows to $118.81 (100 + 9 + 9.81) and another 9 per cent adds about $10.62. This process continues, with the interest rate being applied to larger and larger principal. While the above example assumes that the compounding occurs only once a year, it is possible for the process to occur more frequently. Daily compounding is not uncommon for savings deposits.

Convertible bonds: Bonds that differ from nonconvertible bonds only in that they may be converted into common shares at some predetermined rate at specific times or during specific periods.

Convertible preferreds: Preferred shares. which give the holder preference as to the issuing corporation's assets and dividends and which can be converted to the common stock of the company at a predetermined price at the holder's option (usually within a specified time period).

Coupon rate: Stated rate of return attached to a fixed-income investment.

Credit union: Cooperative association where the members' pooled savings are available for loans.

Currency: Any form of money accepted by a country and in actual use within that country as a medium of exchange.

Current assets: Assets that are expected to be used up or converted to cash within the next year or next operating period, whichever is longer. Cash, accounts receivable, and inventory are the major assets usually included in this group.

Current liabilities: Liabilities that are due or will become due in the next year or the next operating cycle, whichever is longer. They usually include trade accounts payable, bank loans, the current portion of long-term debt, and taxes payable.

Current ratio: Ratio of current assets to current liabilities.

Debentures: Long-term obligations that differ from collateral trust bonds only in that the lender can make a claim only against the borrower's general assets. In the event of a default he does not have a claim against any specific assets.

Debt-equity ratio: Ratio of total debt to total equity.

Debt security: A paper asset based on money loaned to the issuer (e.g., bond, note, commercial paper). A holder of a debt security receives periodic interest payments and full repayment of the original, or face, amount at the date of maturity.

Deduction: In tax computation, an amount that may be subtracted from gross income subject to tax.

Default: A failure to repay borrowed money when due; or, an operating condition of a company wherein it is unable to meet its current financial obligations.

Default risk: The risk that contractual interest or principal will not be paid on debt securities.

Deflation: A general drop in the level of prices. If you now pay only 94 cents for what cost $1 last year, deflation of 6 per cent has occurred.

Depreciation: A deduction from income that allocates the cost of fixed assets over their useful life.

Discount rate: Interest rate charged by the Federal Reserve System on loans to member banks.

Diversification: The technique of spreading an investment portfolio over different investments, types of industries, companies, and risks. This technique is used to minimize risks by making certain that not "all of your eggs are in one basket."

Dividends: Payments made by companies to their stockholders, usually financed from profits.

Dollar averaging (or dollar-cost averaging): A formula investment plan that requires a periodic allocation of a fixed dollar amount, most often on a monthly basis. This practice tends to "average" the unit purchase cost of an investment made over a period of time.

Dow: Usually refers to the Dow Jones Industrial Average, the most commonly used stock market index.

Dow Theory: A type of technical market analysis based on movements of the Dow Jones Industrial and Transportation index averages.

Earnings per common share: The net income of a company, minus any preferred dividends, divided by the number of outstanding common shares. Earnings per share provides the investor or potential investor with information on the stability of dividends, capital gain potential, and the company's performance in relation to other potential investments. This information is usually calculated for a number of fiscal

periods in order to provide an indication of its reliability.

Efficient market hypothesis: The general hypothesis that securities are correctly priced by the market, given relevant information. In its weak form the hypothesis implies that technical analysis and past price and volume data cannot be profitably used in stock selection. The semistrong form implies that all public information is correctly used to price securities and that no superior manipulation of the data can improve stock selection. In the strong form of the hypothesis it is believed that even inside (nonpublic) information is somehow reflected in prices.

Equity or net worth: Assets, minus liabilities; the residual ownership position of the stockholders or owners.

Estate: A person's total worth as determined by his or her vested interests in property and other assets, exclusive of any liabilities.

Euromarkets: Financial markets that operate outside of any national jurisdiction and deal in securities paying unusually high interest rates. These securities are usually based on deposits of large, international corporations or governments of nations involved in extensive foreign trade.

Ex-dividend date: Dividends are paid to stockholders of record on a specified date. Purchases the day after that date (the ex-dividend date) miss the dividend even though they hold the stock on the payment date.

Executor: The person appointed by the testator to carry out the provisions of a will.

Exemption: In tax computation, a release from a tax obligation or liability to which others may be subject.

Exercise value (warrant): Option price, minus marked price of associated stock.

Exordium clause: The introductory portion of a will or other legal document.

Expected value: The sum of the probabilities, multiplied by their associated outcomes; the average value.

Fed: The Federal Reserve System; it exercises monetary policy through its control over reserves of the banking system.

FIFO: First in, first out; inventory valuation whereby items taken out of inventory are assumed to have cost the amount paid for the earliest unused purchase.

First market: Security trading at organized exchanges.

Fiscal policy: Government tax and spending policy that affects the economy.

Flower bonds: Special government bonds that may be used at par for payment of estate taxes.

FNMA: Federal National Mortgage Association. It operates a secondary market in mortgages; previously government owned, but now a private corporation.

Fourth market: Direct security trading between financial institutions.

Full employment: Condition existing when there are about as many job openings as unemployed. Most economists would agree that such a level is approximately 4 per cent unemployed. Some others, however, think 5 per cent is the level, and still others consider 4 per cent too high.

Fundamental analysis: Evaluation of a firm based on its financial, competitive earning, and managerial position.

Funds: Assets in the form of cash or working capital that may be used to generate income.

Futures: Contracts to buy and receive or to sell and deliver a commodity at a date and in accord with established rules.

GAAP: Generally Accepted Accounting Principles; a set of accounting principles to be followed in preparing accounting statements.

Ginnie Mae pass-through: A security that permits an investor to earn high mortgage yields with both principal and interest payments guaranteed by the federal government. The term "Ginnie Mae" is derived from GNMA, an acronym for Government National Mortgage Association, a federal agency.

Gross margin: Net sales of an enterprise, minus the cost of goods sold.

Gross National Product (GNP): A measure of a nation's total output; the sum of the market values of all final goods and services produced annually in the country.

Growth stock: Shares of a company that can achieve rapid growth; growth stocks often carry above-average risks and price/earnings ratios.

Hedging: Taking opposite positions in related securities in the hope of profiting from related price movement.

Holding company: Company that has voting control of other corporations and whose sole purpose is to maintain voting control of other business enterprises.

Income averaging: A method of tax calculation in which the taxpayer may figure the amount due based on the average of his or her income for several past years. The taxpayer whose income fluctuates greatly from year to year may find income averaging useful in lowering his overall tax bill.

Income statement: Financial statement providing a picture of the firm's interim earnings; income statements show how revenues were

spent and how much remained as net income.

Income stock: Stock whose principal return is in the form of dividends.

Incorporation: The forming into a legal body endowed with various rights and duties. In some cases, a person can gain certain financial advantages through incorporation.

Indenture of a bond: Delineation of all the promises the company makes to the bondholder. Among these commitments is a promise to pay a stated amount of interest periodically and return the face value (usually $1,000) of the bond at the end of a certain period of time (such as 20 years after issue). A trustee, usually a bank, is charged with overseeing the issuing firm's commitments.

Index fund: Mutual fund that attempts to match the overall market's performance.

Individual Retirement Account: A pension plan that allows a person to set aside a portion of his or her yearly income in a tax-deferred account for distribution at retirement.

Inflation: A general rise in the level of prices. If it now takes $1.06 to buy what $1 would last year, inflation of 6 per cent has occurred.

Interest: Amount a borrower pays for the use of funds. This is frequently expressed as an annual percentage of the principal balance outstanding and calculated on a monthly, quarterly, or annual basis.

Investment companies: Companies whose sole purpose is to earn income by investing in other corporations. There are two types of investment companies: *closed-end*, an investment company that has a fixed number of shares outstanding that are traded like other shares; *open-end* (mutual fund), an investment company that increases or decreases its shares outstanding by directly buying and selling its own shares.

Keogh plan: A pension plan in which self-employed persons may set aside a portion of their yearly income in tax-deferred accounts for distribution at retirement.

Leverage: The technique of using borrowed funds or special types of securities (warrant, calls) in an attempt to increase the rate of return on investment. This technique requires that the interest on borrowed funds be less than the rate of earnings on total funds employed or that the leverage premium be recaptured. While the rate of return using leverage is greater than that without it, the risk to the investor is also increased because the principal and specified rate of interest must be repaid.

Liability: An obligation or debt.

LIFO: Last in, first out; items taken out of inventory are valued at most recent invoice cost.

Limit order: An order to buy or sell, if it is possible to do so, at a specified price.

Liquidity: The ease with which an investment can be converted to cash.

Listed and unlisted stocks: Listed stocks are approved for trading by one or more of the stock exchanges; unlisted stocks (that is, stocks not listed for trading on an exchange) are traded over-the-counter between brokers.

Load: Sales charge that a buyer of mutual funds must pay on top of the net asset value of the shares.

Long-term (fixed) assets: Tangible assets of a relatively long life that are not intended for resale and that are used in the operations of the business; include plant and equipment, but not inventories or accounts receivable.

Long-term liabilities: Liabilities not due in the next operating period; usually include bonds, debentures, mortgages, and similar types of debt.

Management control: Condition existing when no ownership group has a large enough share of the stock to exercise control; usually leads to control by the managers.

Margin: Securities bought on margin are partially financed with borrowed money. The Federal Reserve System regulates the extent of margin borrowing by setting the margin rate. If the rate is 60 per cent, $10,000 worth of stock may be purchased with up to $4,000 of borrowed money. Only listed securities and some of the larger over-the-counter companies' stock qualify for margin loans.

Marginal tax bracket: The income tax category that establishes the rate owed by a taxpayer on the top dollar of income he or she receives.

Market cycle: Commonly used term in technical stock and market analysis, reflecting the "normal" pattern of trading of a security or market based on historical performance in similar situations, time periods or economic conditions.

Market indexes: There are a number of averages or indexes of stock market performance. The Dow Jones Industrial Average is the best known and most closely watched. It is calculated by adding the market prices of 30 leading industrial companies and dividing by a divisor. This divisor is changed periodically to reflect stock splits. Dow Jones also has an average for utility and transportation stocks. Standard and Poor's investor service, *The New York Times*, the NYSE and AMEX, among others, have their own indexes.

Market order: Order to buy or sell at the market price.

Market risk: Volatility associated with general market movement; not diversifiable within the market.

Marketability: The ease with which an investment can be bought or sold without seriously affecting its price. For example, blue-chip stocks are usually highly marketable, since they are actively traded.

Monetarist: One who emphasizes the role of monetary policy in guiding the economy.

Monetary policy: Government policy affecting the economy through impact on money supply. The Federal Reserve influences the money supply through its control of bank reserves and required reserves.

Money market: The market for high-quality short-term securities. Among the money-market instruments are CD's, commercial paper, acceptances, Treasury bills, short-term tax-exempt notes, and Eurodollar loans.

Money-market fund: A mutual fund that invests in the money market.

Mortgage: Claim on a property held by the person who has lent money that is payable by the buyer of the property. The claim protects the lender in case the money is not repaid when due.

Mortgage bonds: Debt securities for which specific collateral is pledged.

Municipals: Tax-free bonds issued by state and local governments.

Mutual funds: Companies that buy and sell investment assets with the gains and losses accruing to the owners; may be either load (with sales fee) or no-load (no sales fee).

Mutual insurance company: An insurance arrangement in which the policyholders are also the insurers.

NASDAQ: An automated information system that provides brokers and dealers with price quotations on securities traded over-the-counter. NASDAQ is an acronym for National Association of Securities Dealers Automated Quotations.

NAV: Net asset value; the per share market value of a mutual fund's portfolio.

Net worth: Assets, minus liabilities; the residual ownership position of a firm.

Nonmarket risk: Also called firm risk; the risk associated with an individual firm not related to general market movements; usually diversifiable.

Notes: Intermediate-term debt securities issued with maturity dates of from one to five years.

NOW account: Negotiable Order of Withdrawal – a special type of savings account that draws interest and allows the depositor to write

checks on his funds. All depository institutions can offer such acounts to their customers.

NYSE: New York Stock Exchange – the world's most important and active investment-trading market.

Odd lot: Transaction involving less than one round lot of stock. Most stock is traded in round lots of 100 shares; trading in odd lots requires the payment of an odd lot differential.

Open market operation: The Federal Reserve's transactions in the government bond market; they affect bank reserves and, thereby, the economy and money supply.

Option: The exclusive right to buy or sell property or securities at a specified price within a specified time.

Option price: The amount at which the warrant holder may purchase stock; sometimes called exercise price or striking price.

Over-the-counter: A method of direct trading by stock and bond dealers, doing business on a principal basis, of stocks that are not listed on a securities exchange.

Owner controlled: Condition existing when an individual owner or ownership group owns enough stock for effective control of a firm.

Partnership: A legal relationship involving two or more persons joined under contract as principals in a business.

Par value of common stock: Has almost no significance; it is usually set well below the original offering price of the stock. The firm cannot legally pay dividends if its net worth falls below the total par value of its outstanding stock.

Par value of preferred stock: Unlike common stock's par value, the par value of preferred is relevant. Most preferred is sold in $100 par units. A dividend of $6 a year is paid on 6 per cent $100 par stock.

Pension: A grant paid to a person following his or her retirement from employment or to his or her surviving dependants.

Points: An extra charge usually imposed by a lender for making a loan. Three points on a $30,000 mortgage correspond to a $900 fee (3 per cent of the $30,000) for granting the loan. This fee is in addition to closing costs (a fee for legal and other services incurred in negotiating the loan) and the interest on the loan.

Portfolio: A combination of investment assets, such as a group of stocks or bonds; the holdings of investments by an individual, institution or other group. A "balanced" portfolio includes a variety of investments designed to achieve a number of objectives and, at the same time, minimize risk. See also *diversification*.

Preferred stock: Like common stock, represents ownership in a company, but usually preferred shareholders forego voting rights (unless otherwise specified) and receive specified dividends that are paid before dividends on the common shares. They may also be preferred as to capital in the event of liquidation.

Premium (warrant): The market price of a warrant, less its exercise value.

Premium (convertible bond): Normally, market price, less conversion value; at times, however, may refer to market price, less straight debt value of the bond.

Present value: The current dollar equivalent of a future stream of income; the amount is found by discounting the stream at some selected interest rate.

Price earnings ratio: Market price of a stock, divided by its earnings per share. This ratio is used as a measure of reasonability of the share price.

Primary market: The initial market for the distribution of securities; after this initial sale, they are traded in the secondary market.

Principal: A capital sum placed at interest, due as a debt or used as a fund.

Profit (or loss): Net revenues, minus costs and expenses. A profit-and-loss statement is a financial accounting of revenues and expenses during a specified period of time (e.g., three months or one year). See also *income statement*.

Proprietorship: The condition of ownership of a business. There are several types, among them the sole proprietorship, or ownership of a business by a single individual; the partnership; and the corporation.

Prospectus: Official document that all companies offering new securities for public sale must file with the SEC. A prospectus spells out in detail the financial position of the offering company, the planned use of new funds, and the qualifications of the corporate officers, among other things.

Purchase accounting: Assets of merged firms that are entered on the books of the acquiring firm at amounts equal to the value of the purchase price of the firm.

Put: Option to sell stock at specified price over specified time period.

Random walk: In the physical sciences this type of behavior is called Brownian motion; a random walk is analogous to the movement of a drunk in the middle of a large field. At any point in time he is as likely to move in one direction as any other. There is no way of predicting his direction of movement. Similarly, the random motion of stock prices implies that the next price change is as likely to be up as down, regardless of

past price behavior.

Rate of return: Takes into acount both dividends and capital appreciation (increases in the price of the stock). A rate of return of 9 per cent implies that one who owns $100 worth of stock will a year later have made a profit of $9 in dividends and capital appreciation.

Real return: Adjusts for changes in the price level. If the rate of return is 11 per cent in monetary terms, a 9 per cent inflation rate reduces the real return to 2 per cent.

Rebate: A return of a portion of a payment.

Recession: In the past, two successive quarters of decline in real (in non-inflationary dollars) Gross National Product have signaled the start of a recession. Recessions and depressions differ in degree, with depressions being much more severe.

Repurchase agreement ("repo"): An agreement to buy back a certain amount of securities at a slightly higher rate than the selling price.

Return: The profit from labor, investment, or business. Also, a statement showing tax calculations and the amount due, if any.

REIT: Real-estate investment trust. Such companies buy and manage rental properties. If they pay out 90 per cent or more of their income, no corporate profit tax is due.

Reserve requirement: The percentage of reserves the Federal Reserve requires each bank to have on deposit for each dollar of demand or time deposits.

Retained earnings: That portion of net profits not paid out as dividends.

Rights: The opportunity, at the discretion of the company, for shareholders to acquire new stock at a specified price and in relation to the number of shares currently held.

Risk-reward ratio: A measure of the amount of risk assumed in seeking a specific level of profit. Generally, the greater the risk assumed, the larger the potential return, and vice versa.

Rollover: A refund; most commonly used to denote a change from one type of investment to another.

Round lot: The basic unit in which stocks are traded. For most securities it is in 100 shares.

S Corporation: An arrangement whereby a corporation may be taxed as a partnership under the provisions of the Internal Revenue Code.

S & P: Standard & Poor's Corporation. An important firm in the investment area that rates bonds, collects and reports data, and computes market indexes.

SEC: Securities and Exchange Commission – the federal agency with direct regulatory authority over the securities industry.

Second market: The over-the-counter market.

Secondary offering: Public offering of securities made outside the usual exchange or over-the-counter market. Those making the offering wish to sell more of the security than they believe can be absorbed by the market's usual channels. A secondary offering spreads out the period for absorption.

Securities: Any of a host of paper assets representing a claim on something of value. Stocks, bonds, warrants, puts, calls, commodity contracts, and warehouse receipts are examples.

Selling short: A form of speculation in which you expect the price of a stock to decline. Securities are borrowed and sold and are later bought back, with the shares restored to the original owner.

Short squeeze: Pressure applied to those who sell short when powerful forces compete to drive up the price.

Simple interest: Interest paid only on the principal and computed only on the principal. See *compound interest* for comparison.

Sinking fund: A fund used to retain a specific portion of a bond issue; many bond indentures require sinking fund provisions so that all of the debt will not come due simultaneously.

Speculating: The act of committing funds at high risks in the hope of realizing large returns.

Spread: The difference between the price bid, or offered, for a share of stock and the price offered for that share; commonly used in quoting prices on the over-the-counter market. Also, in options trading, a strategy involving the purchase or sale of two options on the same security but with different conditions (i.e., the same striking price but different maturities, or the same maturity but different striking prices).

Stock split: The division of a company's existing stock into more shares (say, two-for-one or three-for-one) with the approval of the shareholders. This is frequently done to reduce the price per share in order to improve the marketability of the shares.

Stop-limit order: An order to execute a limit order when the market price reaches a certain level.

Stop-loss order: An order to sell or buy at market when a certain price is reached.

Straddle: A strategy used in options trading involving the purchase or sale of both a put and a call on the same security with the expectation that you can profit on both or that the assured profit on one will exceed the indefinite potential loss on the other.

Striking price: The amount an option holder must pay to exercise the option.

Syndication: A type of real-estate venture that allows a group of investors to pool its money for the purchase of large income-producing properties.

Tangible investments: A broad group of commodities that includes precious metals and stones, artifacts, and some collectibles.

Tax credit: A reduction of a tax amount otherwise due.

Tax shelter: An investment designed to yield tax-exempt income for its owner.

TEBF: Tax-exempt bond fund. A mutual fund that invests in municipal bonds, offering tax-free income to the owners of its shares.

Technical analysis: Evaluation of stock based on past price and volume behavior; largely debunked by random-walk hypothesis.

Tender offering: Offer to purchase securities made outside the general market in which the securities are traded.

Term insurance: Straight life insurance without a savings feature; as compared to whole life, rates rise with age to reflect greater probability of death.

Testimonium: The concluding portion of a will.

Testor (or testator): A person who leaves a will in force at his or her death.

Third market: Over-the-counter market in listed securities, often, lower commissions are available than on the exchange.

Totten Trust: An arrangement whereby funds may be set aside for a minor child.

Treasury bill: (See *Bills*).

Treasury stocks: A company's shares held by the issuing company.

Trust: A property interest held by one person for the benefit of another.

Underwriter: Usually, an investment dealer who agrees to buy all or part of a new security issue from a company, raising the money in the expectation that the securities can be resold to the public at a higher price.

Universal life insurance: A type of life insurance in which the insurance protection (term element) is separated from the investment element to produce a high-yield investment/insurance package.

Variable annuities: Investment vehicles similar to mutual funds and sold by insurance companies.

Warrants: Certificates that guarantee the right to purchase stock in a company at specified prices within specified time limits. When market prices are, or are expected to be, in excess of the price offered, the warrants themselves have a market value and are frequently traded.

Whole life insurance: Life insurance with a savings feature. Premiums are fixed, with a surplus built up early to meet claims that exceed premiums for older groups.

Will: A legal statement of a person's wishes with regard to the disposition of his or her property or estate at the time of death.

Withholding tax: A portion of an employee's income withheld by the employer as partial payment of income tax.

Yield: The return of an investment expressed as a percentage of the market value of the investment.

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